82d Congress, 2d Session
COMMITTEE PRINT NO. 6

THE INTERNATIONAL PETROLEUM CARTEL

STAFF REPORT

TO THE

FEDERAL TRADE COMMISSION

SUBMITTED TO THE

SUBCOMMITTEE ON MONOPOLY

OF THE

SELECT COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

AUGUST 22, 1952

Printed for the use of the Select Committee on Small Business

UNITED STATES
GOVERNMENT PRINTING OFFICE
23541 WASHINGTON : 1952

Approved For Release 2010/04/14 : CIA-RDP57-00384R000700130001-2

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LETTER OF TRANSMITTAL

STEPHEN J. SPINGARN,
Commissioner.

FEDERAL TRADE COMMISSION,
Washington 25, D. C., August 18, 1952.

Hon. JOHN SPARKMAN,
Chairman, Select Committee on Small Business,
United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: Pursuant to the request made in your letter of August 18, 1952, I transmit herewith a copy of the staff report of the Federal Trade Commission on the International Petroleum Cartel.

It is understood that this report will be published by your Monopoly Subcommittee, which is currently holding hearings on the effect of cartels and monopolies on small business. If and when hearings are scheduled concerning our staff report on the International Petroleum Cartel, the Commission will be glad to designate personnel to appear before your committee and discuss the contents of the report.

By direction of the Commission.

Sincerely,

STEPHEN J. SPINGARN,
Acting Chairman.

PREFACE

We are happy to have this staff report by the Federal Trade Commission on the International Petroleum Cartel. Our Monopoly Subcommittee, headed by Senator Long, has already held several hearings and issued a number of reports on monopolistic practices and cartel arrangements, particularly as they affect small business. This subcommittee was appointed in February 1952, and practically from its inception has been beleaguered by requests to investigate the alleged restrictive practices of the international oil industry. On April 23, April 29, and July 16, the subcommittee—in the course of public hearings—announced its keen interest in the staff report of the Federal Trade Commission on international petroleum cartels, and expressed the belief that the report should be released. On July 28, a letter was dispatched to the White House requesting that the report be made public. Now that the President has approved this request, it is entirely appropriate that the report be included as part of our subcommittee's series on monopolies and cartels.

The Senate Small Business Committee has a profound and abiding interest in the effect of monopolistic and restrictive activities on the survival of independent competitive enterprise. Such activities are not always regional or even national in scope. When in exceptional circumstances the fate of competitive free enterprise at home is inextricably linked with the pattern of business operations abroad, this committee will not hesitate to extend its investigations so as to determine the exact nature of these operations. However, our purpose is always the same: to discover the effect of certain business practices and arrangements on the American small-business man and on the American consuming public.

With reference to the alleged Oil Cartel, it has been the aim of this committee to learn (1) whether or not five major integrated American oil companies have joined two foreign companies in a series of international monopoly agreements; (2) whether or not the structure of international oil prices has imposed an excessive burden on the economies of friendly nations, and thus on the American public which is extending economic and military assistance to these nations; and, perhaps most important of all, (3) whether or not the dumping of foreign oil in the United States, at a net cost far below the price charged in Europe and the Middle East, is causing injury to independent American oil producers.

It is our hope that publication of this report will contribute materially to public knowledge and understanding of international business arrangements. It is a factual report and as such is subject, of course, to a variety of interpretations. If any interested party wishes to be heard, this committee will make time available so that all shades of opinion may be represented. Only after such hearings are completed, however, will our committee issue its final conclusions and recommendations on the effect of the alleged International Oil Cartel on

small business, in particular, and the consuming public of America, in general.

I want to make it clear that this report is being published by our committee only after careful study and deliberation. It is my opinion that its release at this time is not likely to jeopardize our national security or undermine the aims of our foreign policy. The security aspect of the matter has been cleared with responsible agencies of Government. As to foreign policy, the goals of the United States in international affairs are clear: To attempt in every way possible to assure justice and freedom, under law, to all peoples of the earth. Publication of this report will certainly not interfere with the attainment of these goals.

There is another important reason for making this report available, and that is to subject the activities of great concentrations of economic power to the spotlight of publicity.

It has long been the public policy of the United States to supplement the legal provisions of the antitrust laws with broad, fact-finding powers. The fundamental purpose of fact-finding is to prevent the abuse of power. Where power exists there also exists the possibility of its abuse. Some two decades ago the Federal Trade Commission, through an economic investigation, restrained the abuse of power by the private utility holding companies. Today the power of the international oil companies is so vast as to invite its abuse. By focusing the spotlight of publicity on the activities of these oil companies, the present report of the Federal Trade Commission, like the earlier investigation of the utility companies, should prevent any possible abuse of power, either at home or abroad.

The Senate Small Business Committee believes that it is the basic philosophy of the United States to oppose vast monopolistic concentrations of economic power. Practically alone among the great nations of the world, the United States—through fact finding and through enforcement of its antitrust laws—endeavors to hold in check the power of giant organizations. Whether privately or publicly owned, such organizations carry with them the inherent possibility that their overwhelming power may be abused to the detriment of the people. The Senate Small Business Committee, in publicizing the operations of the international oil companies, wishes to reaffirm the determination of the American people that American companies, whether at home or abroad, shall so conduct themselves as to promote the interests of all people everywhere.

The Senate Small Business Committee, in issuing this report, is expressing its faith in Justice Brandeis' belief that sunlight is the best of disinfectants and electric light the most efficient policeman.

JOHN SPARKMAN,
Chairman, Select Committee on Small Business.

WASHINGTON, D. C., *August 22, 1952.*

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INTERNATIONAL PETROLEUM CARTEL

INTRODUCTION

On September 19, 1944, the Federal Trade Commission passed a resolution directing its economic staff to conduct a long-range investigation of international cartels.

The resolution stated in part that:

> Whereas the Federal Trade Commission Act authorizes the investigation of trade conditions in and with foreign countries where associations, combinations or practices of manufacturers, merchants, or traders, or other conditions may affect the foreign trade of the United States; and to report to Congress thereon * * * and
>
> Whereas there is evidence that agreements detrimental to the trade, commerce, and security of the United States existed prior to the war, between German and American, British and American, German and British, and between industry groups in other nations * * *
>
> * * * * * * *
>
> Now, therefore, be it
>
> *Resolved*, That the Federal Trade Commission * * * herewith directs the chief economist to make an investigation and inquire into—
>
> The practices, arrangements, agreements, and operations of manufacturers, merchants, or traders operating in export trade.
>
> The effectiveness of the said agreements, arrangements, and associations * * *
>
> * * * * * * *
>
> The effects resulting from the operations of foreign cartels or other combinations of foreign manufacturers, merchants, and traders upon the export trade of the United States of America and the American consumer.

Under that general resolution the Commission has prepared and issued reports dealing with international cartels in seven major industrial fields. These reports are as follows:

Report	Year issued
1. International Phosphate Cartels	1946
2. The Copper Industry	1947
3. The Sulphur Industry and International Cartels	1947
4. International Electrical Equipment Cartel	1948
5. International Steel Cartels	1948
6. The Fertilizer Industry	1949
7. The International Cartel in the Alkali Industry	1950

The Commission felt that the basic purpose of its resolution of 1944 would not have been accomplished without the preparation of a report on one of the most important of the international cartels—the international petroleum cartel. To facilitate the preparation of this report, the Commission on December 2, 1949, passed a supplemental resolution calling for an investigation of the international cartel in this specific industry. This resolution provided as follows:

> Whereas the petroleum industry is one of the largest and most important industries in the United States;
>
> And whereas this industry is very highly concentrated, with the preponderance of total assets, proved reserves, crude production, and refining capacity held by a relatively few large companies;

And whereas it is reported in authenticated, secondary sources that over a long period of years American petroleum companies operating in foreign countries have entered into restrictive agreements among themselves and with petroleum companies of other nations, many of these agreements having reportedly been recently extended and reinforced;

And whereas such restrictive agreements are reported to have had the effect of restraining trade and of affecting prices of petroleum and petroleum products in the United States;

And whereas this problem has been intensified by the importance of recent discoveries of oil in foreign nations: Now, therefore, be it

Resolved, That the Federal Trade Commission, in the exercise of the powers vested in it by section 6, paragraphs (a), (b), and (h) of the Federal Trade Commission Act, and with the aid of any and all powers conferred upon it by law, do forthwith proceed to make an investigation of agreements entered into by American petroleum companies among themselves and with petroleum companies of other nations in connection with foreign operations and with international trade in petroleum and petroleum products and of the relationship of such agreements to domestic trade in and pricing practices of the American petroleum industry; and that the Director of the Bureau of Industrial Economics be hereby authorized to conduct such investigation on behalf of the Commission.

Like its predecessors, the present report, which was thus prepared under a general resolution of 1944 and a specific resolution of 1949, is merely descriptive and fact finding in character. It contains summaries of the facts presented but no recommendations. These summaries are presented at the end of each of the report's 10 chapters.

One of the petroleum companies voluntarily submitted to the Commission certain agreements made subsequent to the date of the Commission's subpena, since, in the opinion of this company, these agreements cast light upon the meaning of some of the documents subpenaed. The discussion in the report makes reference to this supplemental information; but otherwise the analysis of the subpenaed material has not sought to take account of developments subsequent to the date of the subpenas nor of any new agreements that may have been entered into subsequent to that date.

PART I

RESOURCES AND CONCENTRATION OF THE WORLD PETROLEUM INDUSTRY

CHAPTER I

THE WORLD'S PETROLEUM RESOURCES

Petroleum is an exhaustible natural resource; it is of fundamental importance to all phases of industrial activity and indispensable to industrial progress. At times it has been the subject of competition and rivalry; more frequently it has been the subject of agreement and international cartel arrangements. Over the years an international petroleum industry has developed, not only because of the importance of petroleum products, but also because these products are so standardized as to have almost universal acceptance, irrespective of the source of the crude from which they are derived.

WORLD'S RESERVES

The world's petroleum reserves are concentrated in a few countries. As of January 1, 1949, these reserves, excluding those of Russia, were estimated at 73.7 billion barrels, of which more than 90 percent or 69 billion barrels were in six countries: United States, Venezuela, Iran, Iraq, Kuwait, and Saudi Arabia. The following table shows the estimated proved reserves by geographical areas and by countries.

TABLE 1.—*Estimated crude petroleum reserves for world, by areas and principal producing countries, Jan. 1, 1949*

[In thousands of barrels]

Areas and principal countries	Estimated reserves	Percent of world reserves
North America:		
United States	28,000,000	35.75
Mexico	850,000	1.09
Canada	500,000	.64
Other	3,000	
Total	29,353,000	37.48
South America:		
Venezuela	9,000,000	11.49
Colombia	300,000	.38
Argentina	250,000	.32
Trinidad	250,000	.32
Peru	160,000	.21
Other	70,000	.09
Total	10,030,000	12.81
Europe (excluding U. S. S. R. and countries under its control):		
Austria	75,000	.10
Netherlands	50,000	.06
Germany	45,000	.06
Other	9,000	.02
Total	179,000	.24
Africa:		
Egypt	120,000	.16
Other	2,000	
Total	122,000	.16

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TABLE 1.—*Estimated crude petroleum reserves for world, by areas and principal producing countries, Jan. 1, 1949*—Continued

[In thousands of barrels]

Areas and principal countries	Estimated reserves	Percent of world reserves
Middle East:		
Kuwait	10,950,000	13.98
Saudi Arabia	9,000,000	11.49
Iran	7,000,000	8.94
Iraq	5,000,000	6.39
Qatar	500,000	.64
Bahrein	170,000	.22
Other	76,000	.08
Total	32,696,000	41.74
Far East:		
Netherlands East Indies	1,000,000	1.28
British Borneo	150,000	.19
Burma	50,000	.06
New Guinea	50,000	.06
Other	67,000	.09
Total	1,317,000	1.68
Total above countries	73,697,000	94.11
Total world	78,322,000	100.00

Source: DeGolyer and MacNaughton, Twentieth Century Petroleum Statistics, 1949, p. 4.

The distribution of world reserves among the major geographical regions is as follows:[1]

	Percent
Middle East	42
North America	37.5
South America	12.8
Russia and its European satellites	7
Far East	1.3
Western Europe, less than	.5

Of the world's total crude reserves, including those of Russia, American companies control approximately 63 percent, and if Russian-controlled reserves are excluded, the share rises to about 67 percent.

The most important discoveries of new reserves in recent years have been in the Middle East and in Canada. New discoveries in Canada are expected to add more than 1 billion barrels to the total reserves of that country,[2] while the tremendous new discoveries in the Middle East have made that area the most prolific potential supplier of oil in the world.

PRINCIPAL CRUDE PRODUCING AREAS OF THE WORLD

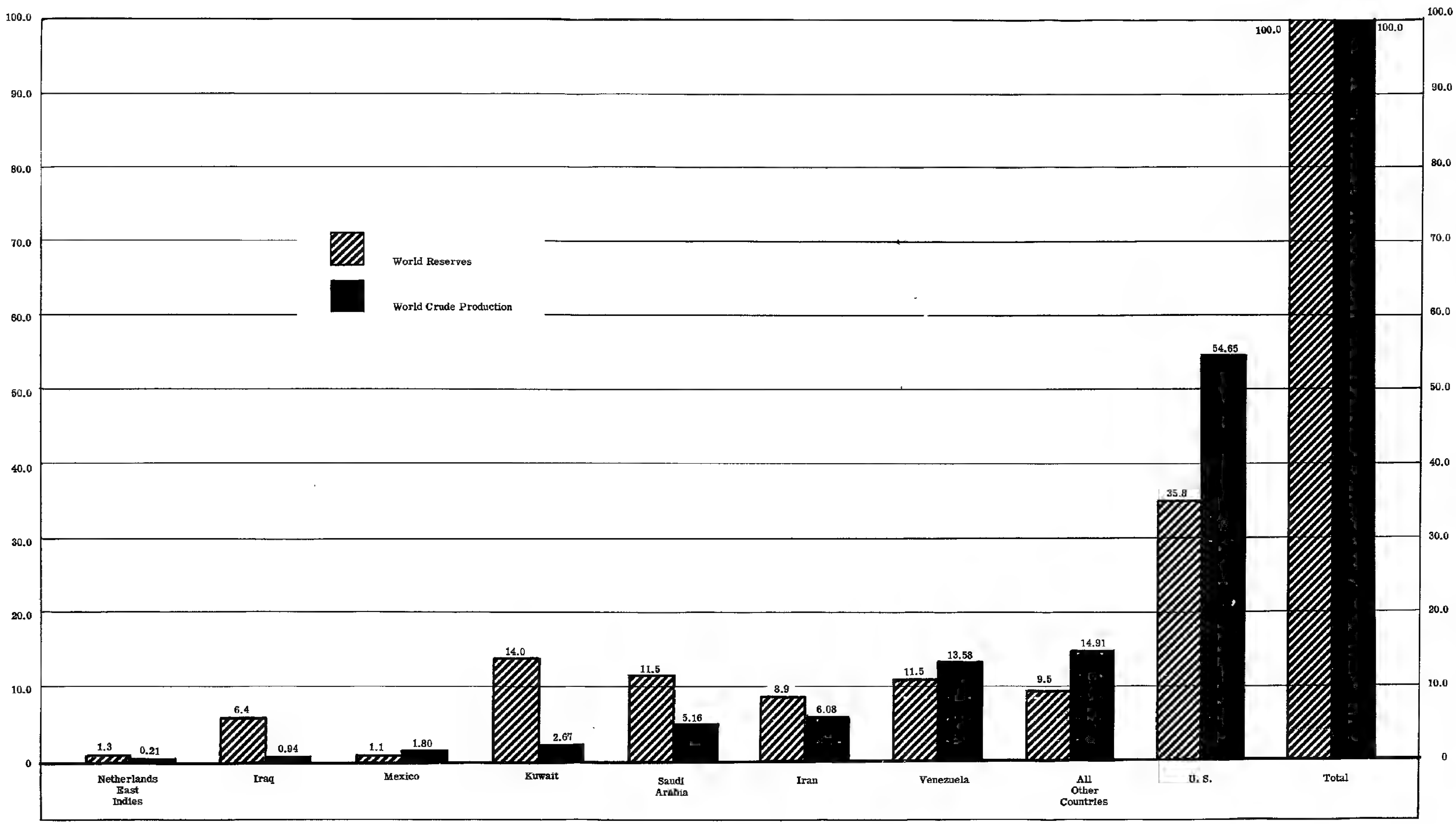
Crude petroleum is produced in more than 40 countries, but in 1949, 7 countries accounted for about 85 percent of the world's total production. These seven countries were the United States, Venezuela, Iran, Saudi Arabia, Kuwait, Mexico, and Iraq. If the production of Russia and Russian-controlled countries is excluded, these seven countries produced more than 92 percent of the world's crude in 1949.

[1] The estimates on which table 1 is based vary in accuracy depending on the data available in each country, the expertness of those making the estimates, the assumptions underlying the data and so on. Estimates for well-developed fields are more dependable than those for newly opened fields, such as those in the Middle East.

[2] World Oil, July 15, 1950, p. 65.

PERCENT OF WORLD CRUDE RESERVES AND PRODUCTION

PRINCIPAL OIL PRODUCING COUNTRIES, 1949



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The production of crude is concentrated in three geographical areas: North America, South America, and the Middle East. In North America, the principal producers are the United States, Mexico, and Canada. In 1949, these three countries produced more than 57 percent of the world's total crude.

Table 2 gives world production in 1949 by country and by geographical area.

The United States has long been the world's most important producer of crude petroleum, and has maintained a relatively constant proportion since the turn of the century. For several years production in the United States has averaged about 60 percent of world production. In 1949, however, this percentage declined to 54.7 percent.

In 1949, production in the United States averaged about 5 million barrels per day from more than 449,000 wells, or an average production of approximately 11 barrels per day per well.[3] In the average of barrels per well per day, the United States ranks far below most other important oil-producing countries.

In 1949, Mexico produced about 60 million barrels of crude, and had seventh place among the important oil-producing countries of the world. Peak production in Mexico was reached in 1921, with 193 million barrels. At that time Mexico was the second largest crude producer in the world. However, production declined rapidly and reached a low of 33 million barrels in 1932. Since the end of World War II, production in Mexico has increased from 43 million to more than 60 million barrels annually. Daily output per well averaged about 160 barrels in 1949,[4] nearly 15 times that of the United States.

[3] World Oil, July 15, 1950, p. 54.
[4] Ibid., p. 44.

TABLE 2.—*World crude oil production, 1949*

[Annual average in thousands of barrels daily]

Country	1949	1948	1939	Percent increase: 1949 over 1948	Percent increase: 1949 over 1939
Canada	59.0	32.5	21.5	81.5	174.4
Cuba	.4	.3	.3	33.3	33.3
Mexico	166.8	159.5	117.7	4.6	41.7
United States	5,043.0	5,512.0	3,465.6	−8.5	45.5
Total North America	5,269.2	5,704.3	3,605.1	−7.6	46.1
Argentina	63.0	64.8	51.1	−2.8	23.3
Bolivia	1.8	1.3	.6	38.4	200.0
Brazil	.3	.4	----------	−25.0	----------
Colombia	82.3	64.9	65.5	26.8	25.6
Ecuador	7.3	7.0	6.3	4.3	15.9
Peru	40.5	38.4	37.1	5.5	9.2
Trinidad	56.5	54.9	52.8	2.9	7.0
Venezuela	1,320.0	1,338.8	566.0	−1.4	133.2
Total South America	1,571.7	1,570.5	779.4	.1	101.7
France	1.1	1.1	1.4	----------	21.4
French Morocco	.4	.2	----------	100.0	----------
Germany	16.3	12.1	12.3	34.7	32.5
Italy	.2	.2	.3	----------	−33.3
Netherlands	11.8	9.4	----------	25.5	----------
Egypt	42.9	36.0	12.8	19.2	235.2
United Kingdom	.9	.9	----------	----------	----------
Total Europe and Africa	73.6	59.9	26.8	22.9	174.6
Bahrein	30.0	29.8	20.8	.7	44.2
Iran	552.0	518.5	214.0	6.5	157.9
Iraq	84.0	72.2	84.3	16.3	−.4
Kuwait	245.0	127.2	----------	92.6	----------
Saudi Arabia	475.0	390.0	10.8	21.7	4,298.1
Total Middle East	1,386.0	1,138.0	329.9	21.8	320.1
British Borneo	68.0	55.0	19.5	23.6	248.7
Burma	.5	.5	21.6	----------	−97.7
India	5.3	5.3	6.4	----------	----------
China	1.8	1.8	----------	----------	----------
Indonesia	112.0	86.6	170.5	29.3	−34.3
Japan	3.7	3.1	7.3	19.4	−49.3
New Guinea	4.9	.4	----------	1,125.0	----------
Pakistan	1.8	1.2	(1)	50.0	----------
Total other Asia (Far East)	198.0	153.9	225.3	28.7	−12.1
Total (less Russia and Eastern Europe)	8,498.5	8,626.6	4,966.5	−1.5	71.1
Albania	2.5	1.0	2.6	150.0	−3.8
Austria	18.0	17.0	3.4	5.9	429.4
Czechoslovakia	.9	.5	.3	80.0	200.0
Hungary	10.5	10.0	3.0	5.0	250.0
Poland	2.7	2.7	10.7	----------	−74.8
Rumania	86.0	93.4	125.0	−7.9	−31.2
Russia	690.0	600.0	605.0	15.0	14.0
Yugoslavia	2.5	1.0	150.0	----------	----------
Total Russia and Eastern Europe	813.1	725.6	750.0	12.1	8.4
Total world	9,311.6	9,352.2	5,716.5	−.4	62.9

[1] Included with India prior to 1947.

Source: The Oil and Gas Journal, Jan. 26, 1950, p. 206.

Canada is a relatively new addition to the list of important oil-producing countries. Since 1947, many new oil fields have been discovered in Canada. These discoveries, coupled with additional development of older fields, enabled Canada to produce at an average rate of 59,000 barrels per day in 1949. This was an increase of 174 percent over 1939, and 81.5 percent over 1948. As additional pipelines

and refineries are constructed, and as the new fields are extended and developed, further increases in production may be realized.

Ranking second to the United States in production of crude is South America, especially the Venezuelan-Caribbean area. In addition to Venezuela, which produced at the rate of about 1,320,000 barrels daily in 1949, crude oil is produced in significant amounts in Colombia, Argentina, Peru, and Trinidad. The total crude output of the latter four countries averaged 240,000 barrels per day in 1949. Total production in South America accounted for more than 16 percent of the world's output in 1949.[5]

Production per well in the Venezuela-Caribbean area is generally much higher than in the United States, and is exceeded only by the wells of the Middle East. In 1949, the average production per well per day in Colombia was 69 barrels, in Argentina 47 barrels, in Trinidad 25 barrels, in Peru 11 barrels, and in Venezuela—South America's most important crude producer—200 barrels.[6]

The third important area of crude oil production is the Middle East, which includes Iran, Iraq, Saudi Arabia, Kuwait, and Bahrein. In 1949, about 15.5 percent of the world's crude output was obtained from this area. The average daily rate of production for the five most important Middle East countries was close to 1,400,000 barrels daily.[7] Although oil was produced in the Middle East prior to World War I, it is only since World War II that the Middle East has developed into an important potential supplier of the world's crude. The vast potential of this area is indicated by the fact that total production in 1949 came from only 287 wells, with an average output per well per day of 5,143 barrels. In Iraq, the average production per well per day was no less than 11,200 barrels, in Iran 2,190 barrels, in Saudi Arabia 6,083 barrels, and in Kuwait, almost 4,450 barrels.[8] By drilling more wells and building more pipe lines, the Middle East could undoubtedly become the leading oil producing area of the world. Despite the difficulties in obtaining supplies and equipment during World War II, production increased 320 percent between 1939 and 1949.

In the Far East, the important producing countries are the Netherlands East Indies and British Borneo, which, however, produced in 1949 only about 2 percent of world production.[9] This area has not fully recovered from war damage, and during the past year political disturbances have hampered operations.

Russia and Eastern Europe, including Rumania, produced about 8 percent of the world's crude in 1949, nearly all of which was used by countries under Soviet influence.[10]

Although the world's production of crude petroleum is derived from the same areas and countries that have the crude reserves, a comparison of the distribution of reserves with crude production in 1949 reveals wide disparities in the relative positions of some countries, as is indicated in table 3.

It will be seen from table 3 that some countries are drawing on their reserves at a much faster rate than others. For example, in

[5] Ibid., p. 54.
[6] Ibid., p. 54.
[7] Estimates of production do not always agree. World Oil, July 15, 1950, gives the average daily production of the Middle East (including Iran, Iraq, Saudi Arabia, Kuwait and Bahrein) as 1,473,718 barrels, while the Oil and Gas Journal, January 26, 1950, gives production for the same countries as 1,386,000 barrels daily.
[8] World Oil, July 15, 1950, p. 54.
[9] Ibid., p. 42.
[10] Ibid., pp. 42–43.

1949, the United States produced about 55 percent of the world's crude but held only 35.8 percent of the world's crude reserves. The percentages of world production by Venezuela and Mexico also exceed their respective percentages of world reserves. On the other hand, Kuwait and the other major holders of reserves in the Middle East had a percentage of world production much below their percentage of world reserves. The Middle East, however, is developing rapidly, and its reserves, as well as its annual share of the world's crude production, are expected to increase in the future.

WORLD CRUDE OIL REFINING CAPACITY

A country's ability to convert crude petroleum into usable products is indicated by its refining capacity. The statistical picture of refining capacity, crude runs to stills, and production is presented in table 4, by country and by geographical area for the year 1949.

TABLE 3.—*Percent of world crude reserves and production, 1949*

Country	Percent of estimated world reserves [1]	Percent of world crude production [2]
United States	35.8	54.65
Kuwait	14.0	2.67
Venezuela	11.5	13.58
Saudi Arabia	11.5	5.16
Iran	8.9	6.08
Iraq	6.4	.94
Netherlands East Indies	1.3	.21
Mexico	1.1	1.80
Total	90.5	85.09
All other countries	9.5	14.91
Grand total	100.0	100.00

[1] Source: DeGolyer and MacNaughton, Twentieth Century Petroleum Statistics, 1949, p. 4. (For comments on the accuracy of these estimates see p. 3, footnote 1.)
[2] Source: World Oil, July 15, 1950, p. 42.

TABLE NO. 4.—*World crude oil refining capacity, crude runs to stills and production, 1949, by country and geographical area*

[In thousands of barrels daily]

Country	Crude refining capacity barrels daily as of July 1, 1950 [1]	Crude runs to stills 1949 [2]	Production 1949 [2]
North America:			
Canada	341,550	263,216	57,562
Cuba	6,080	5,389	477
Mexico	201,190	136,003	166,877
United States	6,750,000	5,330,189	5,041,937
Total	7,298,820	5,734,797	5,266,852
South America and Caribbean:			
Argentina	129,800	100,000	62,907
Bolivia	2,790	1,658	1,858
Brazil	3,515	1,622	299
Chile	360		301
Colombia	30,900	23,167	81,430
Ecuador	5,700	4,340	7,170
Netherlands West Indies	657,000	696,405	

See footnotes at end of table, p. 11.

TABLE No. 4.—*World crude oil refining capacity, crude runs to stills and production, 1949, by country and geographical area*—Continued

[In thousands of barrels daily]

Country	Crude refining capacity barrels daily as of July 1, 1950 [1]	Crude runs to stills 1949 [2]	Production 1949 [2]
South America and Caribbean—Continued			
Peru	34, 900	33, 660	40, 521
Trinidad	99, 000	80, 310	56, 485
Uruguay	25, 000	13, 973	----------
Venezuela	287, 950	145, 389	1, 321, 414
Total	1, 276, 915	1, 100, 523	1, 572, 384
Western Europe:			
Belgium	16, 500	7, 263	----------
Denmark	655	663	----------
France	293, 100	230, 879	1, 126
Western Germany	71, 070	33, 863	16, 293
Italy and Trieste	128, 280	60, 729	195
Netherlands	53, 500	53, 425	11, 819
Portugal	7, 000	5, 378	----------
Sweden	24, 800	8, 948	----------
United Kingdom	206, 680	120, 712	926
Total	801, 585	521, 860	30, 359
Middle East:			
Bahrein Island	165, 000	153, 589	30, 096
Egypt	47, 000	42, 660	43, 458
Iran and Kuwait	572, 100	487, 118	807, 238
Iraq	9, 500	6, 115	84, 932
Israel	83, 000	1, 616	----------
Lebanon	11, 000	6, 236	----------
Qatar	----------	----------	2, 055
Saudi Arabia	140, 000	126, 767	476, 734
Turkey	1, 400	142	260
Total	1, 029, 000	824, 244	1, 444, 773
Other Asia:			
China	19, 000	4, 364	2, 060
India-Burma and Pakistan	12, 800	7, 658	8, 274
Japan	51, 127	3, 510	3, 707
Total	82, 927	15, 532	14, 041
Other Africa:			
Canary Islands and Spain	23, 600	11, 482	----------
French Morocco	800	290	373
South Africa	2, 000	----------	----------
Total	26, 400	11, 772	373
Oceania:			
Australia	17, 600	10, 959	3
British Borneo	-35, 000	(175, 860)	68, 789
Indonesia	----------	----------	[3] 123, 101
Netherlands East Indies	146, 300	----------	----------
Total	198, 900	186, 819	191, 893
Total above countries	10, 714, 547	8, 395, 548	8, 520, 674
U. S. S. R. and Eastern Europe:			
U. S. S. R.	675, 000	640, 000	658, 000
Other Eastern Europe	209, 235	131, 096	130, 068
Total	882, 235	771, 096	788, 068
Switzerland, Norway, Korea	7, 850	----------	----------
World total	11, 606, 632	9, 166, 644	9, 308, 742

[1] Source: World Petroleum Annual Refinery Review 1950, vol. 21, No. 8.
[2] Source: Bureau of Mines. World Petroleum Statistics, 1949.
[3] Includes production of New Guinea.

As the table indicates, the three leading refining centers of the world are the United States, the Venezuela-Caribbean area, and the Middle East. In 1949, 58 percent of the world's refining capacity was in the United States, about 8 percent in Venezuela and the Netherlands West Indies, and nine percent in the Middle East. Excluding U. S. S. R. and eastern Europe, more than 86 percent of the world's refining capacity was located in these three important refining areas. These areas are all important crude producing centers, with the exception of the Netherlands West Indies, which produces no oil but refines large quantities of crude imported from Venezuela and other South American producing countries.

In the Middle East, large refineries are located on the Persian Gulf at Abadan, Bahrein, and Ras Tanura. At the eastern end of the Mediterranean are refineries at Haifa and Tripoli, which operate on crude from the Middle East fields. Since the Middle East is not a large consumer of oil, the products from these refineries must necessarily move to other parts of the world—principally Europe and the Far East.

Western Europe held in 1949 approximately 7.5 percent of the world's refining capacity. The total refining capacity of its 82 refineries was less than that of the three large refineries in the Netherlands West Indies. However, since World War II, there has been a tendency to increase the capacity of the European plants. Since western Europe is not an important producer of crude, practically all of its refineries operate on imported crude. Thus, while total refinery runs to stills in this area were about 522,000 barrels daily in 1949, production of crude in the area was only 30,000 barrels per day.

Exactly the opposite condition exists in South America and the Middle East. There, refinery runs in 1949 were less than daily crude production, indicating exportation of crude.

In 1949, the United States had refinery runs of almost 300,000 barrels per day in excess of crude production. Barring any reduction in crude stocks, the excess of crude runs is an index of the volume of crude imports.

Only a small percentage of the world's refining capacity is located in the Far East. This part of the world is neither an important producing nor consuming area, and refining capacity is about equal to crude production.

WORLD PETROLEUM CONSUMPTION AND SUPPLY

Just as the geographic pattern of reserves differs from that of production, and the pattern of production differs from that of refining, so also does the pattern of consumption differ from the other variables. The geographic differences in "demand" and "supply," which are synonymous terms in the petroleum trade for consumption and production, are indicated in table 5 for the years 1947 and 1949. Thus the table reveals those areas of the world which consumed more oil than they produced, as well as those areas which produced in excess of domestic needs.

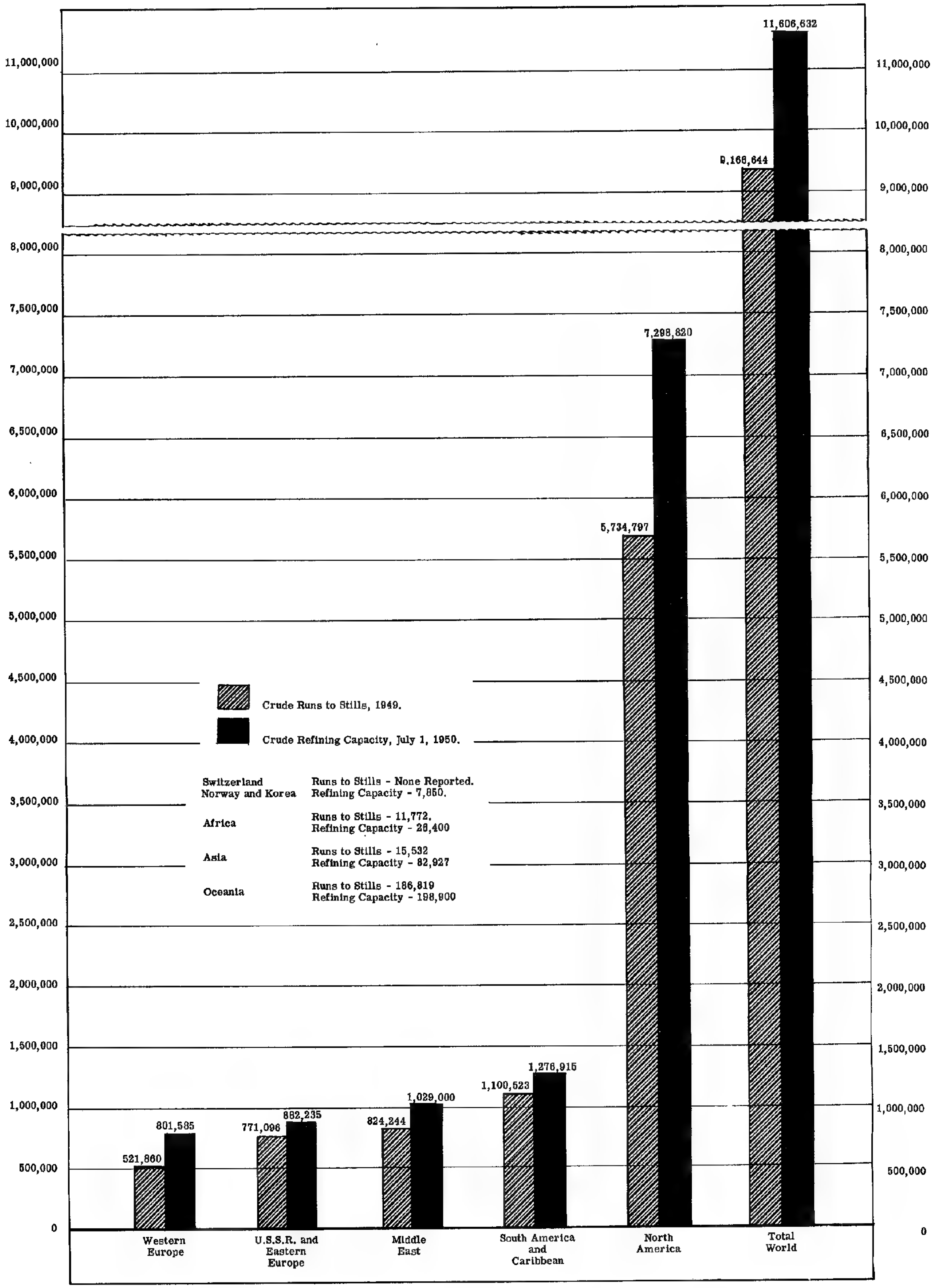
The only two areas of the world that produced more petroleum than they consumed in 1947 and 1949 were the Caribbean and the Middle East. All other areas were dependent upon the surplus-

CHART 2.

WORLD CRUDE RUNS TO STILLS AND REFINING CAPACITY

BY GEOGRAPHIC AREA

(in barrels, daily)



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producing regions to make up the balance between their consumption and production. These deficit areas were Europe, Africa, the Far East and Oceania, and parts of North and South America.

One of the most striking developments revealed in table 2 is the rise of the Middle East as an important supplier of the world's petroleum needs. In 1947, the Middle East had an excess of supply over consumption of about 671,000 barrels daily; by 1949, this excess had nearly doubled, reaching 1,191,000 barrels daily, which was almost enough to surpass the Caribbean area as a surplus producer of petroleum.

In the United States in 1949 consumption exceeded domestic supply by about 322,000 barrels daily, while in 1947 consumption and supply were approximately equal.

Taking the major producing areas as a whole, in 1949 the United States, the Caribbean, and the Middle East supplied 85 percent of the world's oil but consumed only 64 percent. Thus a surplus of 21 percent, or about 2,120,000 barrels per day, was available for the deficit-producing countries.

TABLE 5.—*Petroleum demand and supply by areas, 1947 and 1949*

[In thousands of barrels daily]

Country	Domestic demand [1]	Domestic supply [2]	Excess of supply over demand	Excess of demand over supply	Percent of world supply	
					Domestic demand	Domestic supply
1949						
United States	5,792.4	5,470.4		322.0	59.42	55.70
Other North America	478.2	232.2		246.0	4.91	2.36
Total, North America	6,270.6	5,702.6		568.0	64.63	58.06
Caribbean area	212.9	1,464.1	1,251.2		2.18	14.91
Other South America	397.5	117.8		279.7	4.08	1.20
Total, South America	610.4	1,581.9	971.5		6.26	16.11
Europe (excluding U. S. S. R.)	1,226.7	176.2		1,050.5	12.59	1.79
Africa	236.8	44.5		192.3	2.43	.45
Middle East	211.8	1,402.9	1,191.1		2.17	14.29
Far East and Oceania	484.0	205.7		278.3	4.97	2.10
Total, world (excluding U. S. S. R.)	9,040.3	9,113.8	73.5		92.75	92.80
1947						
United States	5,449.2	5,449.2			62.36	62.02
Other North America	487.3	176.8		310.5	5.58	2.03
Total, North America	5,936.5	5,626.0		310.5	67.94	64.65
Caribbean area	181.6	1,318.4	1,136.8		2.08	15.15
Other South America	262.3	106.0		156.3	3.00	1.22
Total, South America	443.9	1,424.4	980.5		5.08	16.37
Europe (excluding U. S. S. R.)	1,010.6	161.9		848.7	11.57	1.86
Africa	180.3	26.5		153.8	2.06	.30
Middle East	168.8	840.3	671.5		1.93	9.66
Far East and Oceania	419.5	70.5		349.0	4.80	.81
Total, world (excluding U. S. S. R.)	8,159.6	8,149.6		10.0	93.38	93.65

[1] "Demand," as used by the industry trade press, equals consumption plus or minus additions to or subtractions from stocks.
[2] Includes production of crude oil, natural gasoline, and synthetic products.

Source: C. J. Bauer, petroleum economist, Standard Oil Co. (New Jersey), published in World Oil, July 15, 1950, p. 40.

Excluding the U. S. S. R., the United States is the only important industrialized country which is able to supply its own petroleum needs. Many of the major crude-oil-producing countries are not highly industrialized and, therefore, have a limited demand for petroleum. Typical of such countries are the nations of the Middle East and South America. The converse is true of most of the countries of Western Europe and Canada (the latter prior to recent discoveries), which are highly industrialized but produce little petroleum.

THE PATTERN OF INTERNATIONAL TRADE IN PETROLEUM

In the preceding sections it has been shown that the geographic distribution of the world's petroleum production differs widely from the geographic distribution of consumption. This wide disparity has given rise to a rather well defined pattern of international trade in the industry.

The principal movements of crude petroleum in international trade are shown for 1948 in table 6.

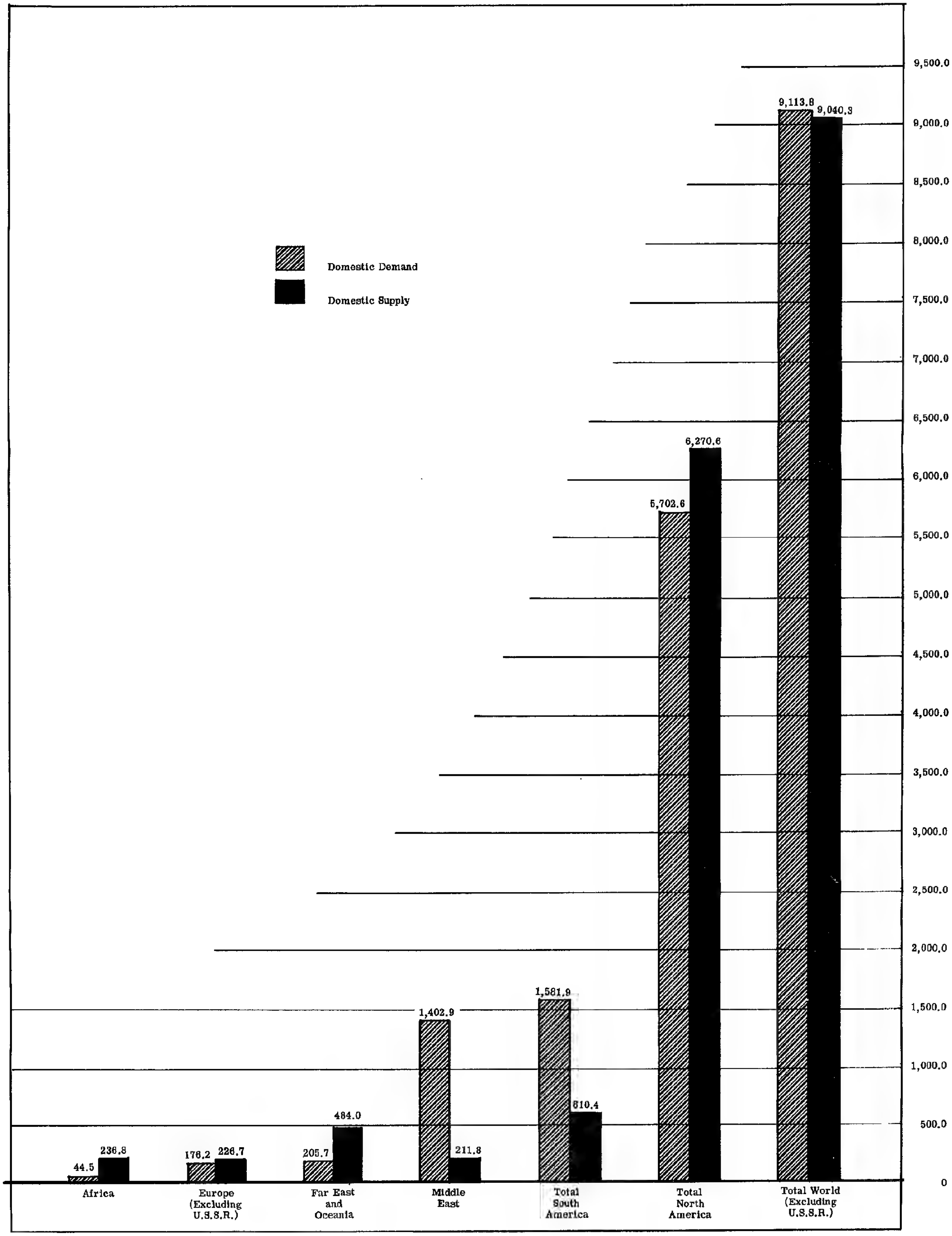
It will be seen that in 1948 there were three dominant movements of crude—all, of course, from surplus areas. From the United States, the principal crude movements were to Canada, Cuba, Argentina, France, and the United Kingdom. From Venezuela and Colombia, large quantities of crude moved to the Netherlands West Indies, United States, and Europe, with small amounts going to Africa, Argentina, and Uruguay. The third major international movement of crude was from Iran and the Persian Gulf [11] to North and South America, Europe, Africa, and Asia.

[11] In preceding sections Iran and the Persian Gulf are included under the more general term "Middle East."

CHART 3.

WORLD PETROLEUM "DEMAND"* AND PRODUCTION
BY GEOGRAPHIC AREA, 1949

(in thousands of barrels daily)



* "Demand" as used by the industry trade press equals consumption plus or minus additions to or subtractions from stocks.

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TABLE 6.—*Principal movements of crude petroleum in international trade, 1948*

[Thousands of barrels]

Imported by—	United States	Mexico	Trinidad	Colombia	Ecuador and Peru	Venezuela	Iran	Persian Gulf	British Borneo and Indonesia	Other	Total
Canada	33,071	213	2,357			37,567	485	3,642			77,335
Cuba	1,506										1,506
Netherlands West Indies				5,186		270,992					276,178
Trinidad				3,547		5,310					8,857
United States		3,601		8,542		93,769	4,507	18,674			129,093
Total, North America	34,577	3,814	2,357	17,275		407,638	4,992	22,316			492,969
Argentina	[1] 1,300			[1] 600	[1] 1,400	[1] 7,300	[1] 250	[1] 2,100		[1] 150	[1] 13,100
Brazil						568					568
Uruguay					232	3,490		[1] 1,007			4,729
Total, South America	1,300			600	1,632	11,358	250	3,107		150	18,397
Belgium and Luxemburg						1,507				743	2,250
France	2,865					10,671	5,602	33,709		1,806	54,653
Germany						296		[1] 1,020			1,316
Italy and Trieste						428	4,645	11,122		4	16,199
Netherlands		951				4,178		2,422		854	8,405
Portugal				82		2,149					2,231
Sweden				486		1,964		[1] 1,275		300	4,025
United Kingdom	471				1,145	9,602	7,068	13,685		1,591	33,562
Total, Europe	3,336	951		568	1,145	30,795	17,315	63,233		5,298	122,641
Bahrein Island								[1] 44,100			[1] 44,100
British Malaya								[1] 275	68		343
China								[1] 1,623			1,623
Indonesia									[2] 6,210	118	6,328
Palestine								[1] 7,318			[1] 7,318
Total, Asia								53,316	6,278	118	59,712
Canary Islands						1,460		[1] 2,750		407	4,617
Total, Africa						1,460		2,750		407	4,617
Australia						253	689		1,694		2,636
Total, Oceania						253	689		1,694		2,636
Shipments in transit, miscellaneous destinations and adjustments	462	2,349	−268	389	−95	−13,937	−3,446	21,652	1,106		8,212
Total exports	39,675	7,114	2,809	18,832	2,682	437,567	19,800	166,374	9,078	5,973	709,184

[1] Estimated. [2] Shipments from British Borneo to Indonesia.

Sources: Bureau of Mines, International Petroleum Trade, Nov. 30, 1949, p. 222.

NOTE.—The foregoing figures, while admittedly based on incomplete data, are believed to represent the major movements of crude petroleum in international trade in 1948.

The movement of crude from the Persian Gulf to North America (United States and Canada) is a relatively new development in the general pattern of international trade in crude. In 1948, about 23 million barrels of crude moved from the Middle East to the United States and Canada, representing approximately 12 percent of all crude exported from the Middle East.

As would be expected, the international movements of crude are from the producing areas to countries which have the refining capacity to convert crude to products, rather than to the important consuming countries. Thus a considerable proportion of the international trade in petroleum moves indirectly to the consuming countries by way of those areas which possess refining facilities. Refining facilities are frequently located where neither production nor consumption of petroleum is important. For example, in 1948, large quantities of crude produced in Venezuela were exported to the Netherlands West Indies for refining, with the products then exported to the consuming countries. In 1948, Venezuela exported 437,700,000 barrels of crude petroleum. Of this total, 270,992,000 barrels, or approximately 62 percent, went to the Netherlands West Indies, which is neither an important producing nor consuming area. Since most of the refined products derived from this crude must be moved to consuming areas, the result is a corresponding increase in the volume of international trade.

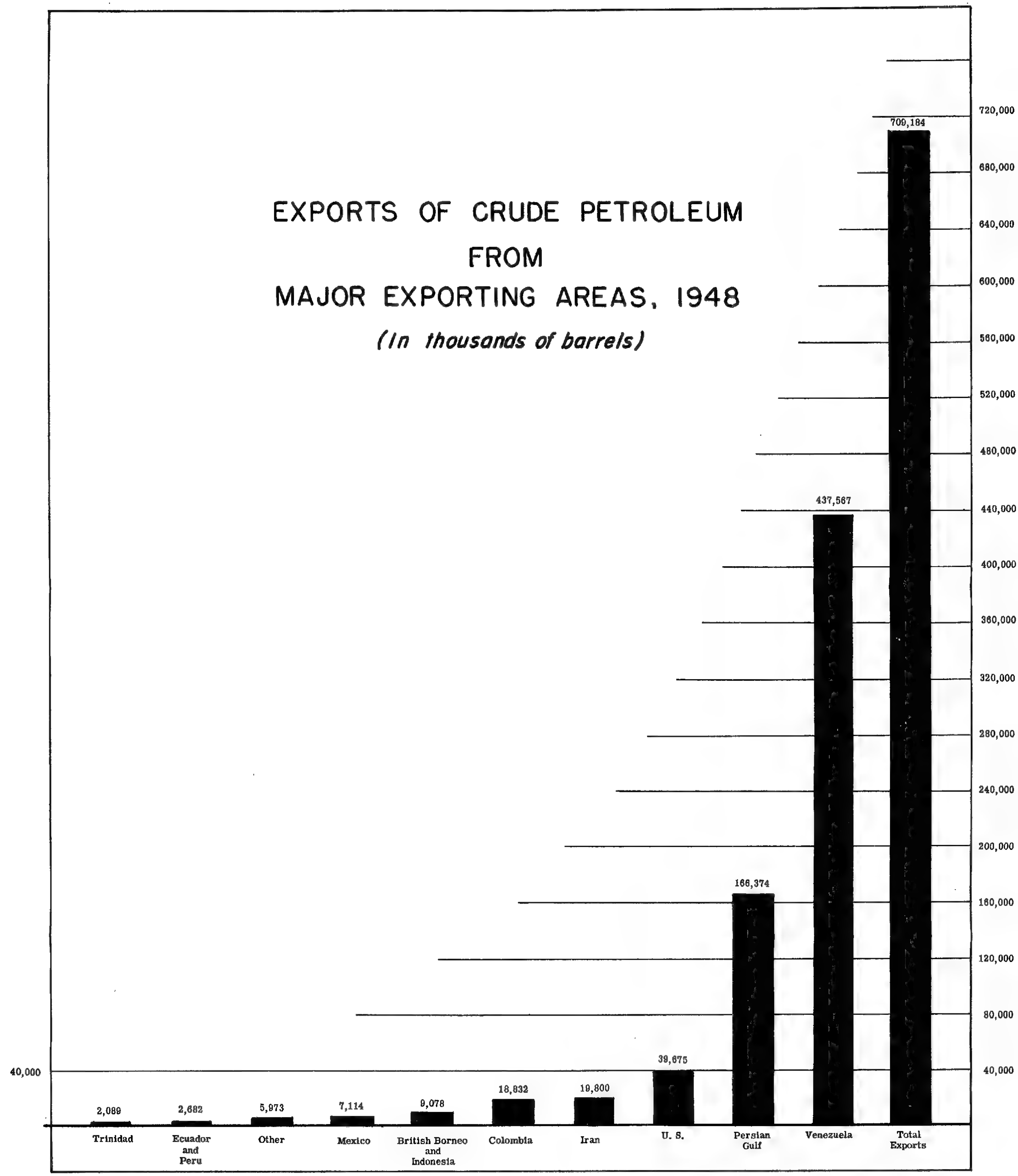
Similarly, the movements of crude from the Persian Gulf to Bahrein Island and Palestine (as shown in table 6) are movements to refining centers, rather than to consuming areas. From these refineries, finished petroleum products are shipped to Europe and Asia.

Another type of movement is the shipment of crude to countries which are important consumers of petroleum products, have considerable refining capacity, but are deficient in crude production. In 1948, France had about 50 percent of the refining capacity of Western Europe, but its crude production accounted for only about six-tenths of 1 percent of refinery runs. About 72 percent, or roughly 40 million barrels, of the imports on which France depended came from the Middle East; while 28 percent, or approximately 14.5 million barrels, came from the United States and Venezuela—primarily from the latter.[12]

Since France's refinery output could not satisfy her requirements, these imports of crude were inadequate. As a result, France imported approximately 7 million barrels of refined petroleum products (motor gasoline and distillate fuel oil)—principally from the United States and the Persian Gulf.[13]

The flow of refined products is shown in table 7, which reveals three principal exporters of refined products: the United States, Netherlands West Indies and Venezuela, and the Persian Gulf. As importers, the major geographical areas stood, in order of importance, as follows: Europe, Asia, North America, Africa, Oceania, and South America. The principal movements of refined products were: (*a*) from the United States to other North American countries, to South America and Europe, with small quantities to Oceania, Asia, and Africa;

[12] Bureau of Mines, International Petroleum Trade, May 31, 1949, pp. 127–128.
[13] Ibid., p. 119.



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(*b*) from the Netherlands West Indies and Venezuela to North and South America, Europe, and Africa; (*c*) from the Persian Gulf to Europe, Asia, Africa, and Oceania.

In summary, there are four principal movements of petroleum and its products: (1) Crude from producing areas to consuming areas; (2) crude from producing areas to refining centers which are not consuming areas; (3) refined products from such refinery centers to consuming areas; and (4) refined products from producing areas with refinery facilities to consuming areas.

TABLE 7.—*Principal movements of refined petroleum products (motor gasoline, distillate fuel oil, and kerosene) in international trade, 1948*

[Thousands of barrels] [1]

	United States	Mexico	Netherlands West Indies, Venezuela	Trinidad	Peru	Europe	Persian Gulf	Palestine	Indonesia and British Borneo	Other	Total
Imported by—											
Canada	14,483		1,811							50	16,344
Central America	738	41	1,461		352					20	2,612
Cuba	1,488	9	777								2,274
Mexico	2,472										2,472
Netherland West Indies	2,743	653	40								3,436
Newfoundland	208		243			52				264	767
Panama Canal Zone	224		1,733		3						1,960
Puerto Rico and Virgin Islands	2,212		143								2,355
United States (continental)		492	1,923	7			685			2	3,114
Other West Indies	1,499		1,671	361						1	3,532
Other North America	391		253			12					656
Total North America	26,458	1,195	10,060	368	355	64	685			337	39,522
Argentina	481		1,422	161						611	2,675
Bolivia	18		115		230					471	834
Brazil	651		10,899	2,285	8	66					13,909
Chile	39		593		2,899						3,531
Colombia			682		853					1	1,536
Paraguay			10								10
Peru	273		85								358
Uruguay	107		122							3	232
Venezuela			493								493
Other South America	25		123	283	63					78	572
Total South America	1,594		14,544	2,729	4,053	66				1,164	24,150
Austria										60	60
Belgium and Luxemburg	580		2,982				2,575			2,359	8,496
Czechoslovakia						862				42	904
Denmark	1,091		3,672			3	814			138	5,718
Finland	39		1,227			12	12				1,290
France	823						877			963	2,663
Germany	5,130		1,300			24	1,900				8,354
Greece	885		116			340	790	370		790	3,291
Iceland	106		439			21					566
Ireland	314		1,746	38		22	484			163	2,767
Italy	421		57			47	146	41		85	797
Netherlands	338		2,721			23	2,487	65			5,634

Norway	98		1,925				1,124				3,147
Portugal	324		931			87	444			208	1,994
Spain			1,930				1,688			759	4,377
Sweden	2,297		8,927	357			2,117			772	14,470
Switzerland	332		37			63	1,271	18		1,254	2,975
Turkey	130					20	1,304	206			1,660
United Kingdom	12,747	944	25,299	4,750		339	15,433	383		1,403	61,298
Yugoslavia						45					45
Other Europe	428					206					634
Total Europe	26,083	944	53,309	5,145		2,114	33,466	1,083		8,996	131,140
Aden							1,215				1,215
Afghanistan							123				123
British Malaya							720		8,399	100	9,219
Burma						2	1,207		10	63	1,282
Ceylon	14						1,227		494	102	1,837
China and Hong Kong	1,852						3,262		251	99	5,464
French Indochina							50		302	83	435
India	25						7,288			882	8,195
Indonesia	1									308	309
Iran								925			925
Iraq	1,061						2,474				3,535
Japan							250				250
Kuwait	978			611			1,913		1,385	1,268	6,155
Philippine Islands	1,040										1,040
South Korea						31	118	126			275
Syria and Lebanon									11	255	266
Thailand	84						1,240	60			1,384
Turkey	29					67	418		6,019		6,533
Other Asia											
Total Asia	5,084			611		100	21,505	1,111	16,871	3,160	48,442
Algeria	183		254			1,583	831		2		2,853
British East Africa							1,902				1,902
British West Africa	140		468	36							644
Canary Islands			1,123	52							1,175
Egypt							3,617			1,472	5,089
French West Africa	17		225	105		2					349
Gold Coast	112		131	33							276
Libya						871	200				1,071
Morocco, French and Spanish	347					989	247			282	1,865
Tunisia	117					188		164			469
Union of South Africa	90						7,758				7,848
Other Africa	255		296	296		226	2,136			100	3,309
Total Africa	1,261		2,497	522		3,859	16,691	164	2	1,854	26,850

See footnote at end of table, p. 20.

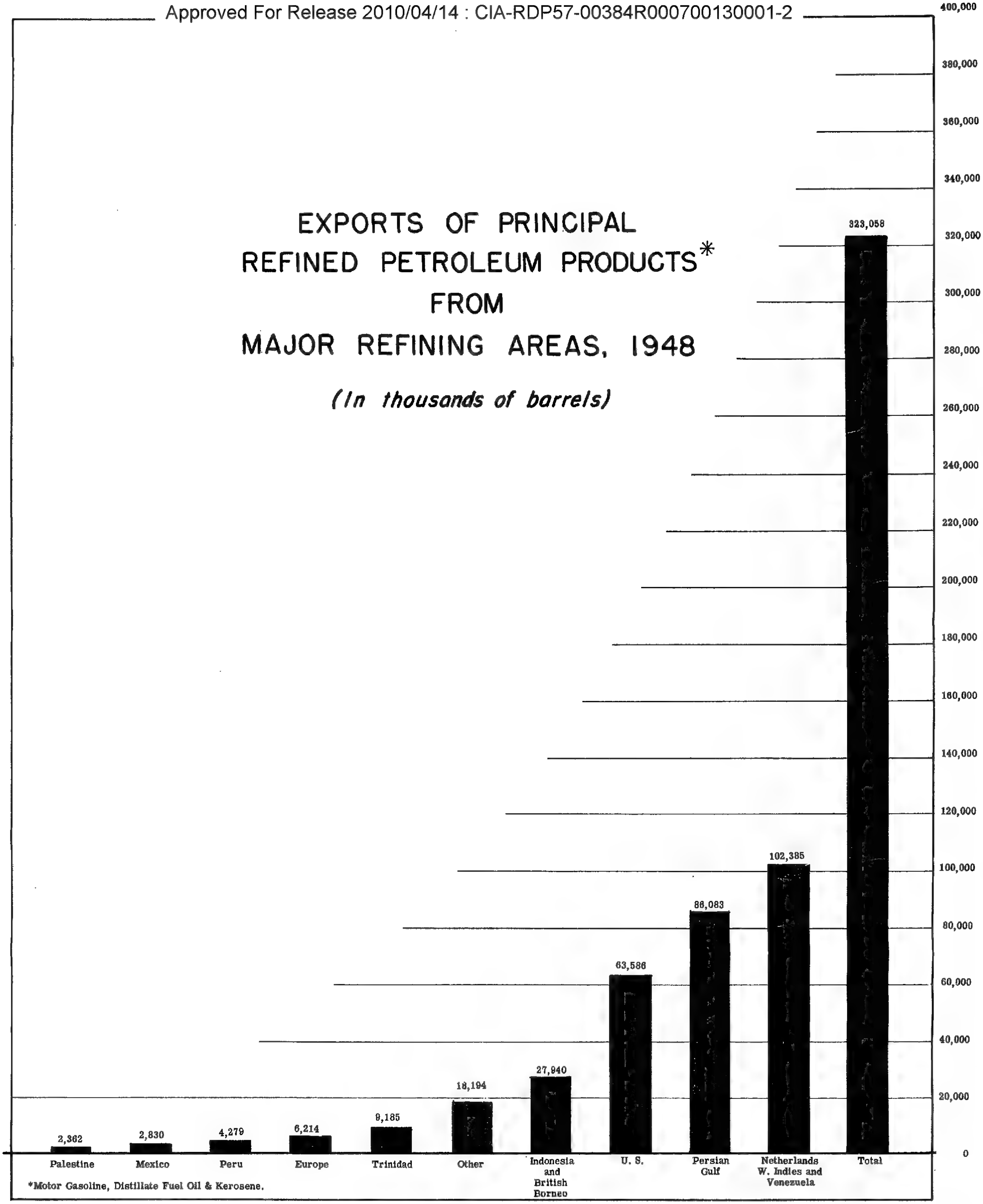
TABLE 7.—*Principal movements of refined petroleum products (motor gasoline, distillate fuel oil, and kerosene) in international trade, 1948*—Continued

[Thousands of barrels] [1]

	United States	Mexico	Netherlands West Indies, Venezuela	Trinidad	Peru	Europe	Persian Gulf	Palestine	Indonesia and British Borneo	Other	Total
Imported by—											
Australia	797					7	9,324		4,302	973	15,403
Hawaii	2,097										2,097
New Zealand	500						3,488		989	1,047	6,024
Other Oceania	139						600		6	38	783
Total Oceania	3,533					7	13,412		5,297	2,058	24,307
Shipments in transit, miscellaneous destinations and adjustments	−6,663	691	15,175	−619	−171		−2,852	4	5,090		10,655
Supplies of vessels in foreign trade	6,236		6,800	429	42	4	3,176		680	625	17,992
Total exports	63,586	2,830	102,385	9,185	4,279	6,214	86,083	2,362	27,940	18,194	323,058

[1] This table is a consolidation of 3 separate tables prepared by the Bureau of Mines which were published in International Petroleum Trade, Dec. 31, 1949, p. 243; February 1950, p. 40; and Apr. 30, 1950, p. 77. In consolidating the tables some modifications were made in the original tables. U. S. S. R. is excluded.

CHART 5.



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CHAPTER II

CONCENTRATION OF CONTROL OF THE WORLD PETROLEUM INDUSTRY

The petroleum industry consists of several separate but related physical operations. The first is exploration and discovery of oil. Once crude oil is discovered, it has to be produced—that is, extracted from the ground—and transported to a refinery which converts the crude into usable products. In some cases refineries are located near the source of production; in others, the oil is moved several thousand miles before it reaches a refinery. From the refinery the finished products are moved to various sales outlets, where they are purchased by the ultimate consumer. Generally speaking, the operations performed by the industry have been classified under four functional headings: exploration and production, refining, transportation, and marketing.

CONTROL OF THE INTERNATIONAL PETROLEUM INDUSTRY

Outside of the United States, control over the petroleum industry (including reserves, production, refining, transportation, and marketing) is divided, for all practical purposes, between state monopolies and seven large international petroleum companies, five of which are American and two British-Dutch.

Control by government monopoly.—In some countries, state authorities control all phases of the petroleum industry from production through marketing, and operations by private companies are prohibited. The most striking example is Soviet Russia, which holds exclusive control over the petroleum industry in Russia, Albania, Austria, Czechoslovakia, Hungary, Rumania, Poland, and Sakhalin. In 1949, these countries controlled 6.1 percent of the world's reserves and accounted for 8.4 percent of world production.

Other countries in which petroleum production is under government operation are Bolivia, Brazil, Chile, China, Mexico, Spain, and Yugoslavia. These countries, in 1949, held only 1.2 percent of the world's crude reserves, and accounted for 1.8 percent of world production. Thus all countries, including Russia and Russian satellites, which owned and operated the petroleum resources in their respective countries, accounted, in 1949, for only about 10 percent of world production and a little over 7 percent of the world's crude reserves. Although Russia and Rumania are important producing countries, they have not been substantial exporters of oil for several years. Mexico, therefore, is the only country in this group which has been a recent quantity producer for the export market.

In contrast to Mexico, many of the state-monopoly countries are not self-sufficient in oil, depending upon imports for part of their supplies. Bolivia, Brazil, Chile, and China imported substantial quantities of oil in 1949, most of which was supplied by one or more of the large international oil companies. In some of these countries, private corporations are permitted to engage in marketing operations.

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For example, the Standard Oil Co. (New Jersey) has subsidiaries which market in Brazil and Chile.

There are also a few countries, such as Argentina and Peru, in which the petroleum industry is operated under a dual system of public and private ownership. In Argentina, Yacimentos Petroliferos Fiscales (YPF), a Government-owned corporation, engages in all phases of the petroleum business. Its total crude production, in 1949, averaged 45,870 barrels per day, compared with a production of 17,300 barrels for all private companies.[1] The state corporation also controls a major portion of the country's refining capacity. Yet, in spite of this dominance of YPF in crude production, Argentina's imports of oil, in 1949, were in excess of 60 percent of consumption.[2] Most of these imports probably came from the seven international oil companies.

In Peru the situation is the reverse. The operations of the Peruvian Government corporation, Emprese Petrolera Fiscal, are insignificant compared to the operations of the private petroleum companies. In 1949, a subsidiary of Standard Oil (New Jersey), International Petroleum Co., Ltd., accounted for more than 80 percent of Peru's petroleum output; a subsidiary of Royal Dutch-Shell produced 18 percent of the output; and the Peruvian Government corporation accounted for only about 1 percent.[3] A comparison of refining capacity in 1950 showed International Petroleum Co., Ltd. with 33,000 barrels daily, while the Peruvian Government corporation had only 1,300 barrels.[4] International Petroleum Co., Ltd., Peru's principal producer, owns its concession in fee simple and pays no royalties to the Peruvian Government.[5]

In summary, the facts about government operations in the international oil industry appear to be as follows:

1. Russia, Roumania, and Mexico are important producers, but only Mexico has any significant production for the export market.
2. State monopolies for the development and production of oil exist in several other countries, which, however, have limited oil reserves and must import the bulk of their requirements from private corporations.
3. Some state-monopoly countries permit private companies to operate side by side with the government organizations, either as marketers (as in Brazil and Chile) or as integrated producers (as in Peru and Argentina).
4. On an over-all basis, state-monopoly countries control only about 7 percent of the world's petroleum reserves and 10 percent of world production. But even these figures overstate the importance of government monopolies, since all state-monopoly countries, except Russia, Roumania, and Mexico, must rely on imports for most of their oil supplies; and, as will be shown later, most of these imports must necessarily come from one or more of the seven international oil companies.

Control by seven international petroleum companies.—The outstanding characteristic of the world's petroleum industry is the dominant position of seven international companies. The seven companies that conduct most of the international oil business include five Ameri-

[1] World Oil, July 15, 1950, p. 104.
[2] Ibid., p. 112.
[3] Ibid., p. 139.
[4] World Petroleum Annual Refinery Review, 1940, vol. 21, No. 8, p. 100.
[5] International's exemption from paying royalties resulted from a decision in 1922 by the International Court of Appeals.

can companies—Standard Oil Co. (New Jersey), Standard Oil Co. of California, Socony-Vacuum Oil Co., Inc., Gulf Oil Corp., and The Texas Co.—and two British-Dutch companies—Anglo-Iranian Oil Co., Ltd., and the Royal Dutch-Shell group.[6] Apart from Mexico and Russian-controlled countries, these seven companies control directly or indirectly most of the world's petroleum business.

Control of the industry by these seven companies extends from reserves through production, transportation, refining, and marketing. All seven engage in every stage of operations, from exploration to marketing. The typical movement of petroleum from producer until acquired by the final consumer is through intercompany transfer within a corporate family. Outright sales, arms-length bargaining, and other practices characteristic of independent buyers and sellers are conspicuous by their absence. Control is held not only through direct corporate holdings, by parents, subsidiaries, and affiliates of the seven, but also through such indirect means as interlocking directorates, joint ownership of affiliates, intercompany crude purchase contracts, and marketing agreements. The remainder of this chapter will show the extent to which control is centralized in these seven corporations.

Control of world crude reserves.—In 1949, the seven international petroleum companies owned 65 percent of the world's estimated crude-oil reserves. Control of reserves means, in effect, control over future oil supplies (unless new reserves or synthetic fuels are developed). These companies held about 82 percent of all foreign reserves (reserves outside the United States) and about 34 percent of the United States (domestic) reserves. United States reserves are held by six of the seven international companies, since Anglo-Iranian Oil Co., Ltd., does not operate in the Western Hemisphere. Outside the United States, Mexico, and Russia, these seven companies, in 1949, controlled about 92 percent of the estimated crude reserves.[6a]

Table 8 shows an estimate of the crude reserves controlled by the seven largest international petroleum companies, as of January 1949.[7]

TABLE 8.—*Estimated crude oil reserves held by 7 international petroleum companies, January 1949*

[In billions of barrels]

	United States	Foreign	Total
Anglo-Iranian Oil Co., Ltd.	----------	13.9	13.9
Gulf Oil Corp.	1.3	5.8	7.1
Royal Dutch-Shell	.8	4.5	5.3
Standard Oil Co. (New Jersey)	3.1	9.3	12.4
Standard Oil Co. of California	1.3	2.8	4.1
Socony-Vacuum Oil Co., Inc.	1.4	2.0	3.4
The Texas Co.	1.5	3.0	4.5
Total, 7 companies	9.4	41.3	50.7
Total estimated reserves, Jan. 1, 1949	28.0	50.3	78.3
Percent of total, 7 companies	33.6	82.1	65.0

Sources: World Oil, December 1948, pp. 37 et seq.; company Annual Reports to Stockholders for 1949; company Prospectuses, and Twentieth Century Petroleum Statistics, by De Golyer and MacNaughton, March 1949.

[6] The parent companies of the group are the Royal Dutch Petroleum Co. and the Shell Transport & Trading Co. These two participate in all interests of the group with shares, respectively, of 60 and 40 percent.

[6a] Any estimate of world reserves is subject to a considerable margin of error, but the important point here is not the absolute amounts but the relative proportions. From World Oil, December 1948, p. 38, ff., it is possible to show that the seven large companies held 98 percent of the crude reserves outside the United States, Mexico, and Russia.

[7] Some of the data used are for 1948, resulting in an understatement of the degree of control.

Control over world crude oil production.—In view of the concentration of control over reserves by the seven international companies, it is to be expected that these same firms would also dominate production. Their importance in the production of crude oil is shown in table 9.

TABLE 9.—*Crude oil production of 7 international petroleum companies by geographical areas, 1949*

[In thousands of barrels daily]

Name of company	Western Hemisphere			Eastern Hemisphere			Grand total
	United States	Other Western Hemisphere	Total	Near and Middle East	Other Eastern Hemisphere	Total	
Anglo-Iranian Oil Co., Ltd				704.7	1.0	705.7	705.7
Gulf Oil Corp	229.7	175.3	405.0	127.7		127.7	532.7
Royal Dutch-Shell	211.0	458.9	669.9	51.0	136.2	187.2	857.1
Standard Oil Co. (New Jersey)	392.0	736.0	1,128.0	153.2	36.5	189.7	1,317.7
Standard Oil Co. of California	275.3	3.6	278.9	158.1	.5	158.6	437.5
Socony-Vacuum Oil Co., Inc	190.9	49.8	240.7	67.4	30.5	97.9	338.6
The Texas Co	288.4	25.3	313.7	158.1	.5	158.6	472.3
Total, 7 companies	1,587.3	1,448.9	3,036.2	1,420.2	205.2	1,625.4	4,661.6
Total production	5,040.0	1,799.2	6,839.2	1,435.0	[1] 257.1	[1] 1,692.1	[1] 8,531.3
Percent of total, 7 companies	31.5	80.5	44.4	99.0	79.8	96.1	54.6

[1] Excluding the production of U. S. S. R. and countries of Eastern Europe under Russian control. Total excluded production was 800,300 barrels daily in 1949.

Source: Company Annual Reports; World Petroleum, January 1950; Moody's Industrials, 1950; and World Oil, July 15, 1950.

It will be seen that in 1949 the seven international petroleum companies accounted for more than one-half of the world's crude production (excluding Russia and satellite countries), about 99 percent of output in the Middle East, over 96 percent of the production in the Eastern Hemisphere, and almost 45 percent in the Western Hemisphere. If United States production is excluded, their share of the output of the rest of the Western Hemisphere is 80.5 percent. If United States production plus that controlled by U. S. S. R. and her satellite countries is excluded, these seven companies accounted for 88 percent of the remaining world's production. This figure understates the degree of control of the private petroleum industry because some of the output outside of the United States and Russia is produced by countries with state monopolies. Since the production of these countries must first satisfy internal demands, it is evident that only a relatively small quantity of crude is available from any source other than one of the seven large companies.[8]

Control over world crude oil refining capacity.—The crude oil refining capacity of the world is also largely controlled by the seven companies, as is shown in table 10.

[8] It should be noted that neither the United States, which now must import petroleum to satisfy its needs, nor the U. S. S. R., which consumes all it produces, is in a position to add to the supplies of petroleum for foreign markets.

CHART 6.

ESTIMATED CRUDE OIL RESERVES (U. S. and FOREIGN)

HELD BY

SEVEN PETROLEUM COMPANIES, January 1, 1949

(in billions of barrels)

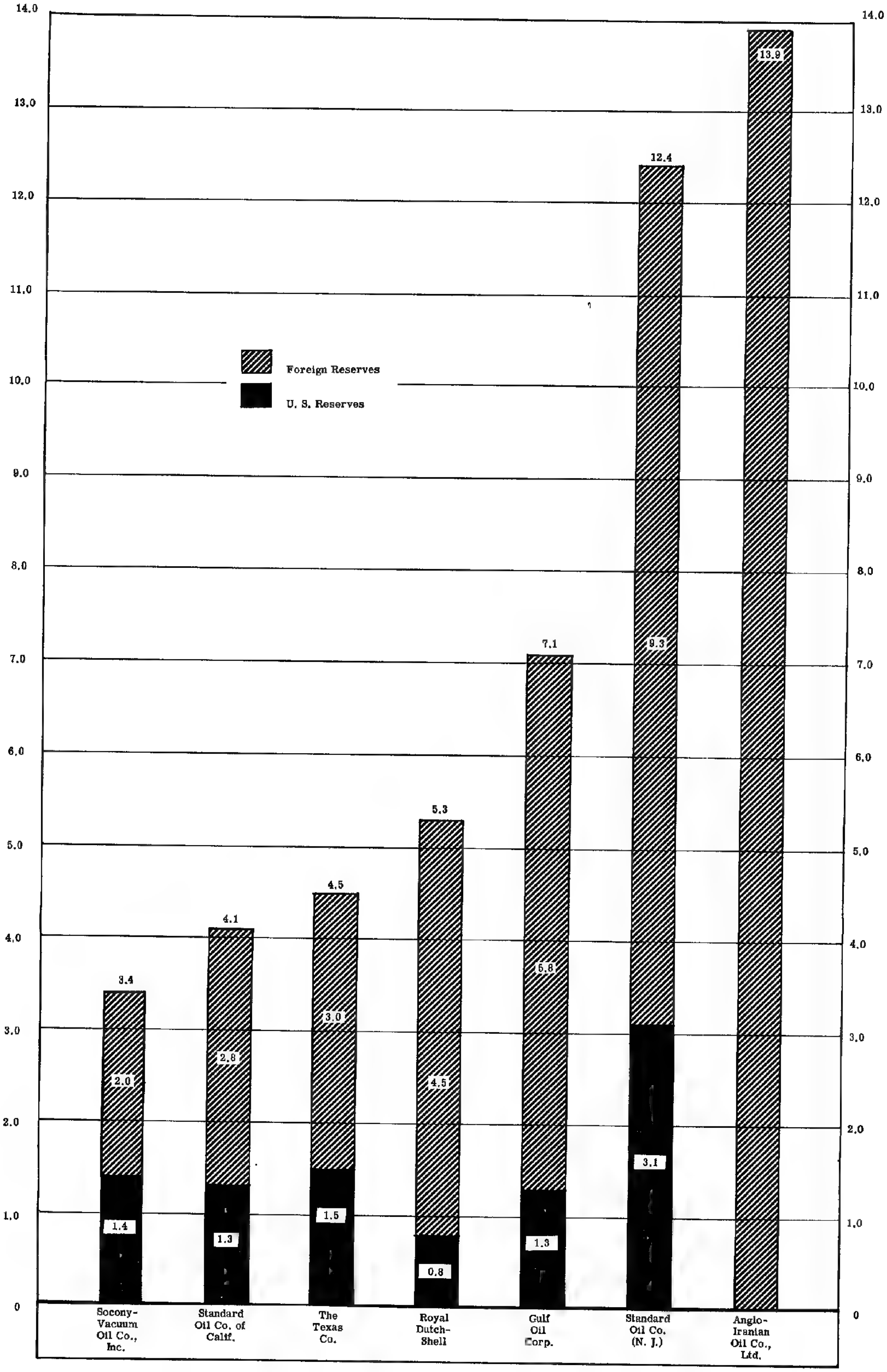

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CHART 7.

OWNERSHIP OF CRUDE OIL RESERVES BY SEVEN PETROLEUM COMPANIES, Jan. 1, 1949

FOREIGN, U. S. and TOTAL

(in billions of barrels)

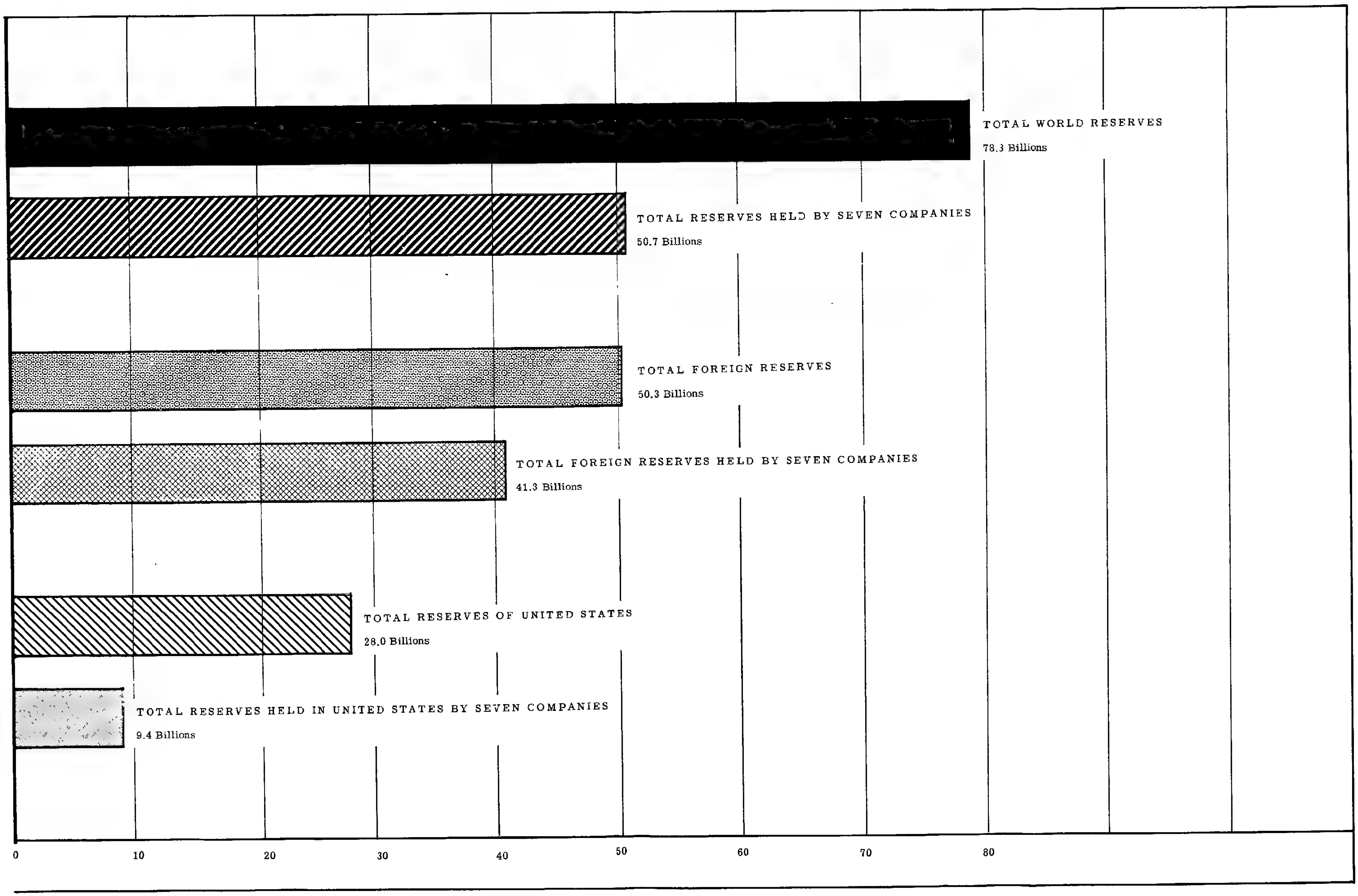

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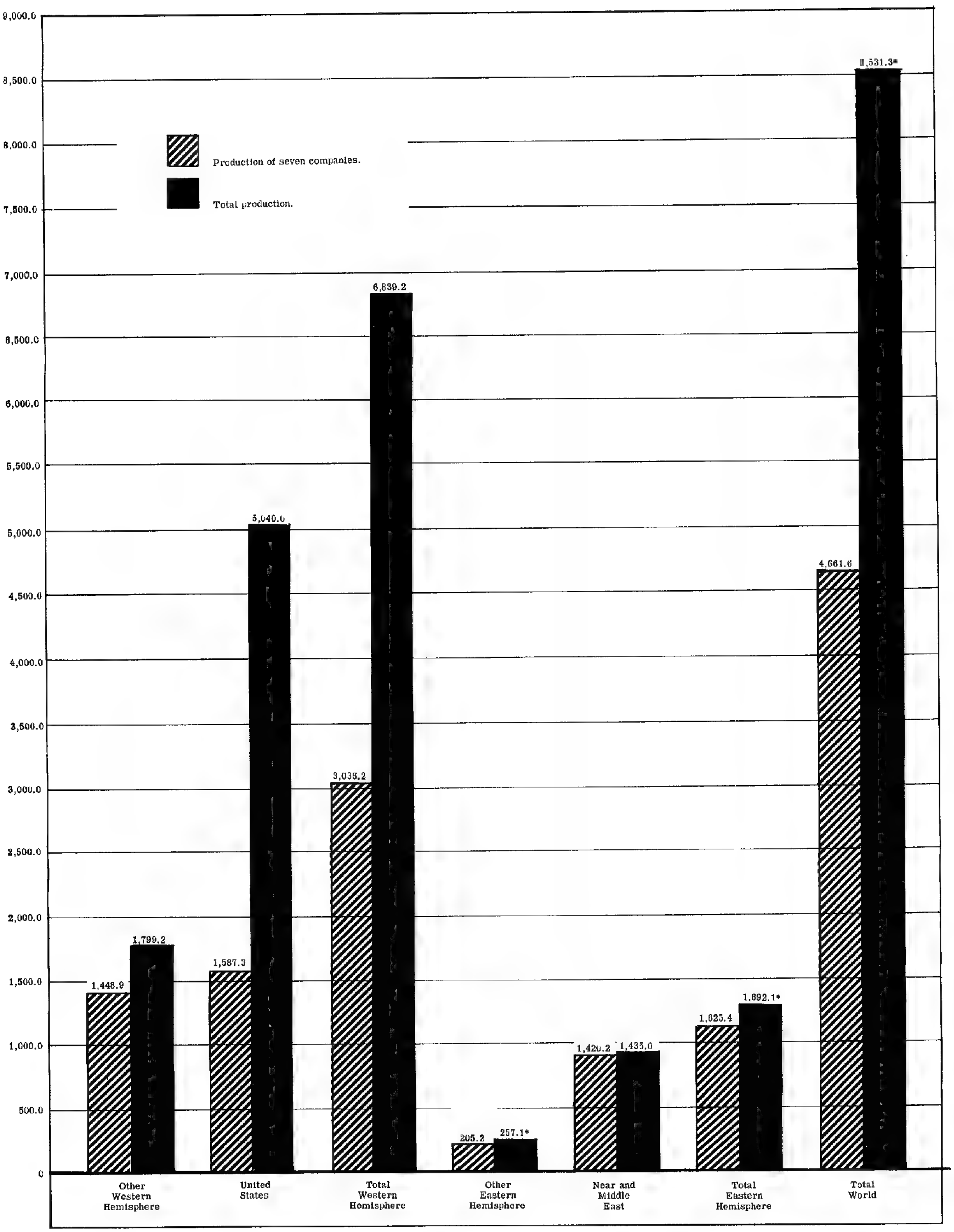
Chart 8.

ESTIMATED CRUDE OIL PRODUCTION BY GEOGRAPHIC AREA

SEVEN COMPANIES AND TOTAL, 1949

(In thousands of barrels daily)



*Totals exclude 800.3 thousand barrels daily of production in U.S.S.R. and countries under Russian control.

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CHART 9.

ESTIMATED CRUDE OIL PRODUCTION (U. S. and FOREIGN)

BY SEVEN PETROLEUM COMPANIES, 1949

(in thousands of barrels daily)

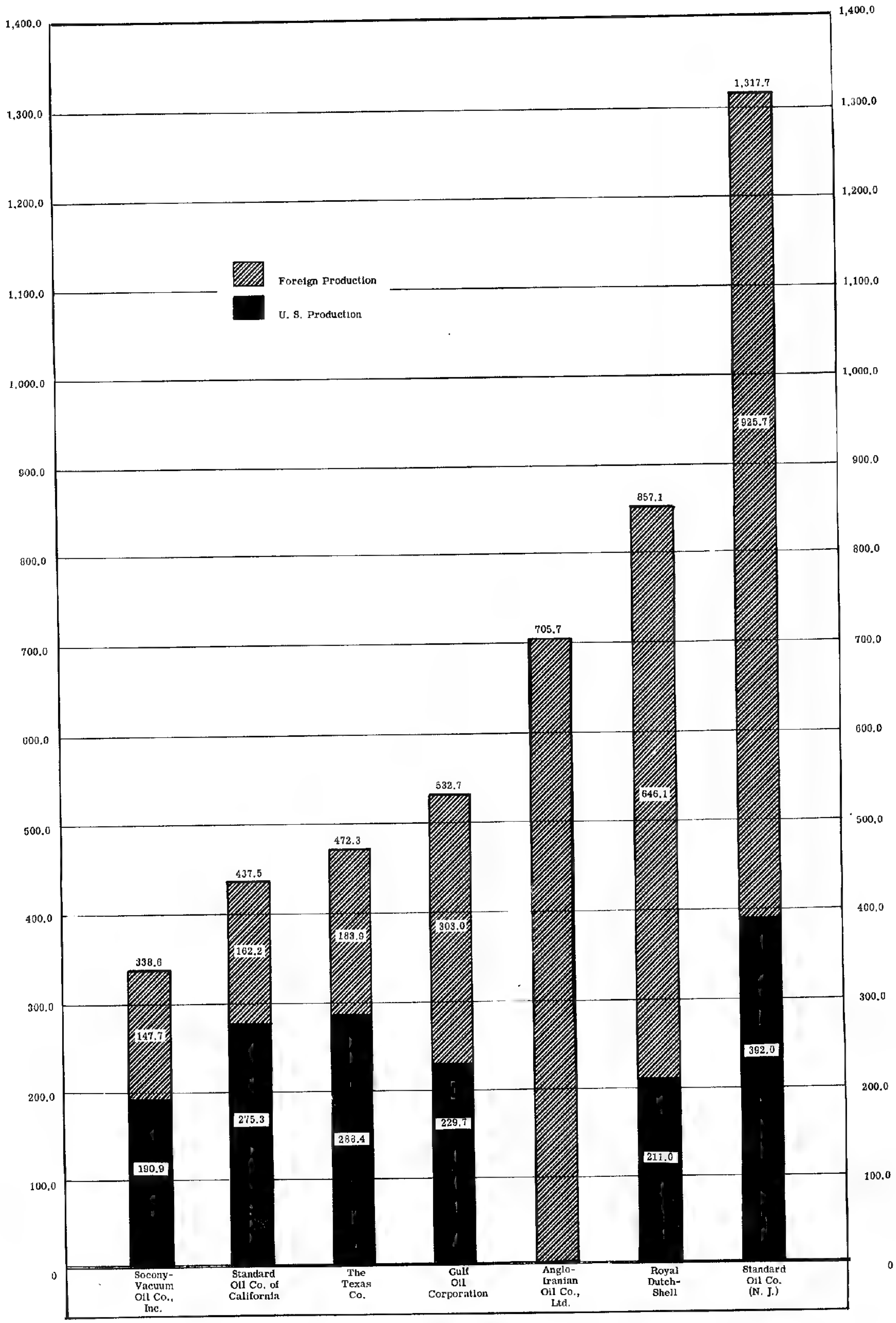

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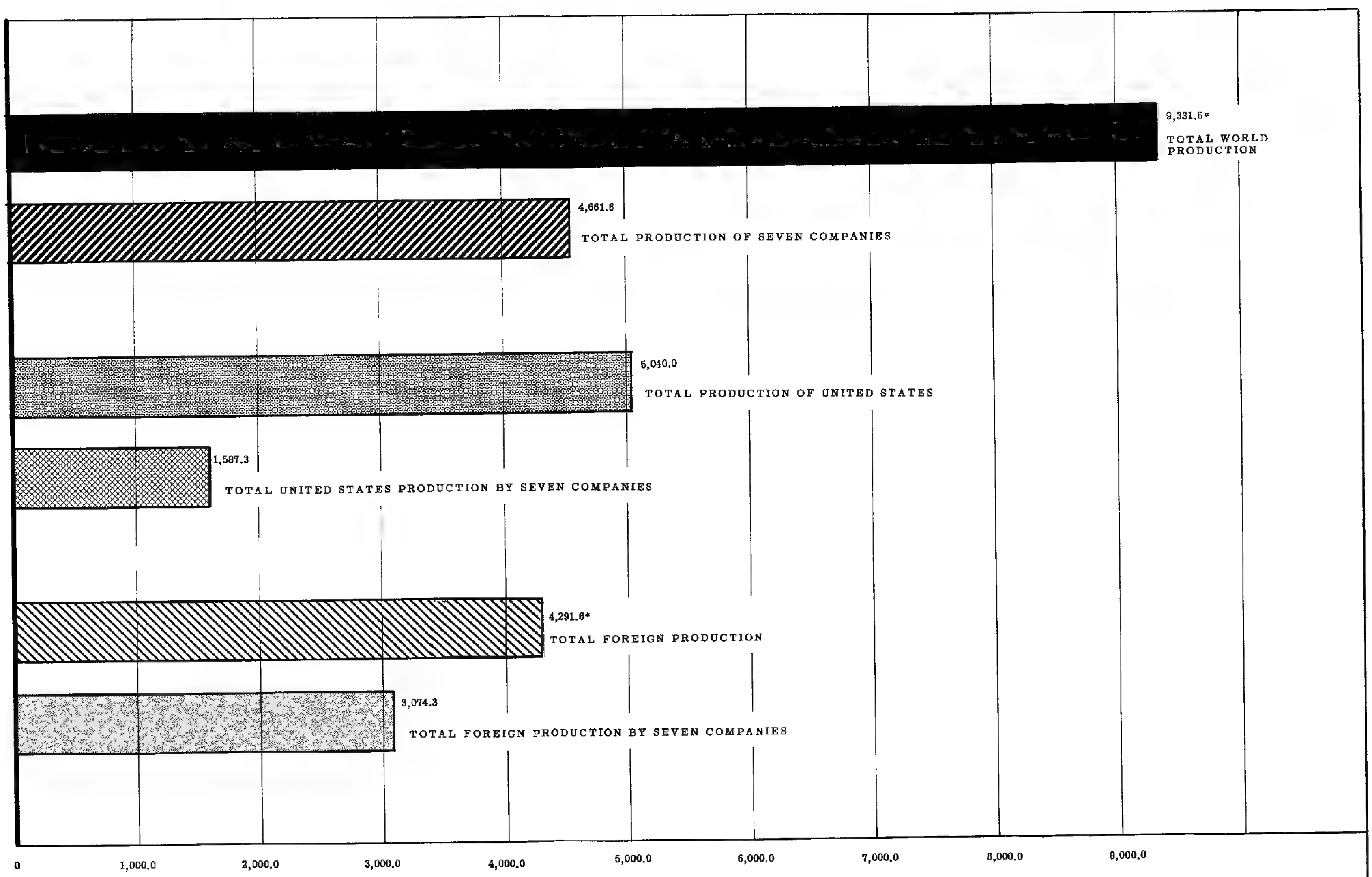
CHART 10.

ESTIMATED CRUDE OIL PRODUCTION BY SEVEN PETROLEUM COMPANIES, 1949

FOREIGN, U. S. and TOTAL

(in thousands of barrels daily)



*Totals include 800.3 thousand barrels daily of production

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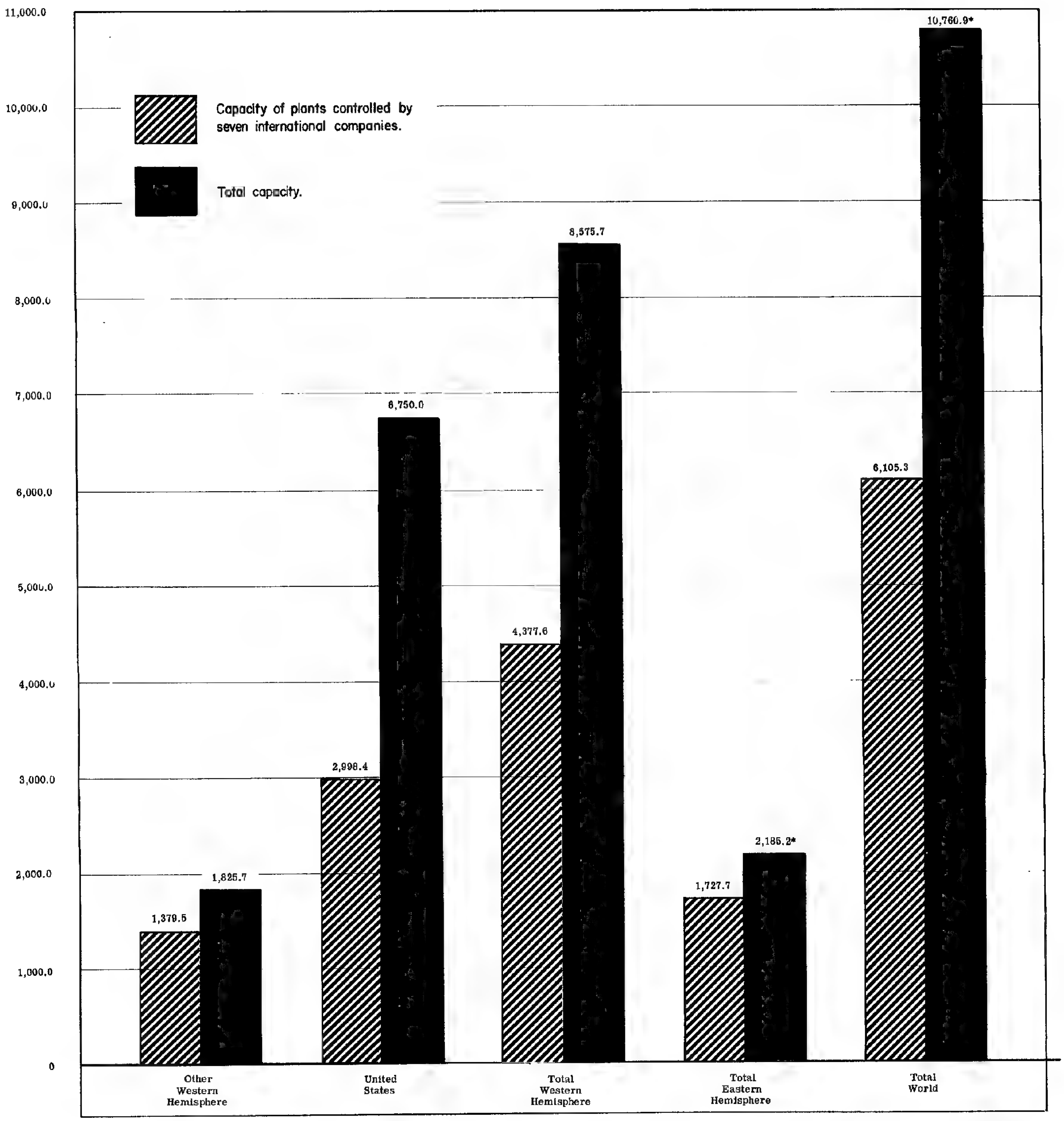
CHART II

ESTIMATED CRUDE OIL REFINING CAPACITY BY GEOGRAPHIC AREA

SEVEN COMPANIES AND TOTAL, 1950

(In thousands of barrels daily)



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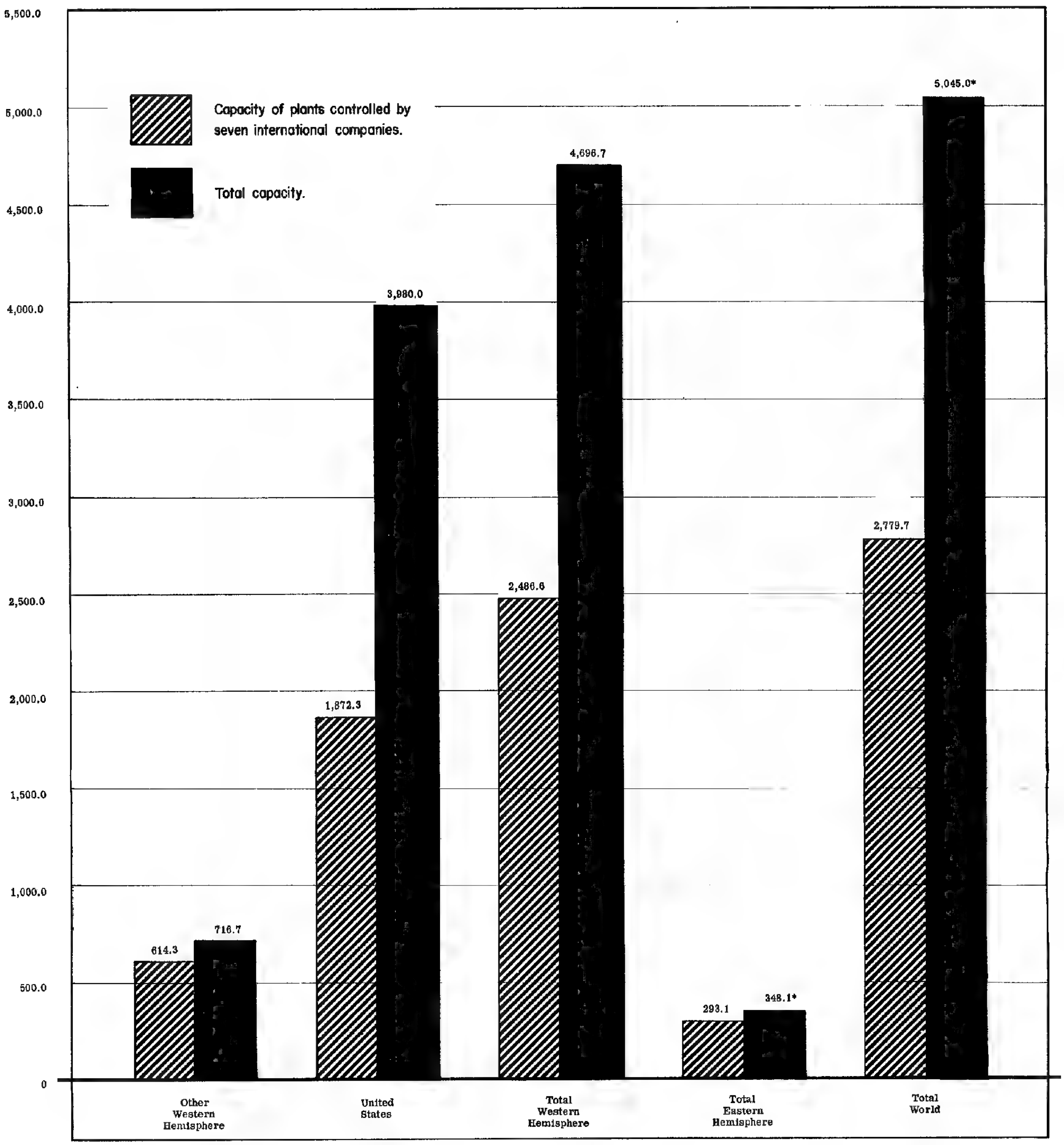
*Excludes capacity of U.S.S.R., Roumania, Hungary, and Poland.

CHART 12

ESTIMATED CRACKING CAPACITY BY GEOGRAPHIC AREA

SEVEN COMPANIES AND TOTAL, 1950

(In thousands of barrels daily)



*Excludes capacity of U.S.S.R., Roumania, Hungary, and Poland.

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TABLE 10.—*Crude oil refining capacity controlled by 7 international petroleum companies, 1950*

[In thousands of barrels daily]

Company	Western Hemisphere			Total Eastern Hemisphere	Grand total
	United States	Other Western Hemisphere	Total		
Anglo-Iranian Oil Co., Ltd				707.9	707.9
Gulf Oil Corp	458.0	21.3	479.3	18.9	498.2
Royal Dutch-Shell	367.0	448.9	815.9	443.0	1,258.9
Standard Oil Co. (New Jersey)	782.0	818.9	1,600.9	145.6	1,746.5
Standard Oil Co. of California	370.7	8.4	379.1	141.9	521.0
Socony-Vacuum Oil Co., Inc	528.5	3.5	532.0	128.6	660.6
The Texas Co	491.9	78.5	570.4	141.8	712.2
Total, 7 companies	2,998.1	1,379.5	4,377.6	1,727.7	6,105.3
Total capacity	6,750.0	1,825.7	8,575.7	[1] 2,185.2	[1] 10,760.9
Percent of total, 7 companies	44.4	75.6	51.0	79.0	56.7

[1] Excluding refining capacity of U. S. S. R., Hungary, Poland, and Rumania.

Source: Refining capacity of individual companies in United States is from Bureau of Mines, Information Circular 7578, Petroleum Refineries, Including Cracking Plants in the United States, Jan. 1, 1950. Statistics for Eastern Hemisphere, other Western Hemisphere and total capacity are from World Petroleum, Annual Refinery Issue, Vol. 21, No. 8, 1950, and from the companies' Annual Reports for 1949.

As the table indicates,[9] the seven international oil companies controlled, in 1950, almost 57 percent of the world's crude-oil-refining capacity. In the Western Hemisphere, excluding the United States, they held more than 75 percent; and in the Eastern Hemisphere, 79 percent. Excluding the capacity of the United States and that under Russian control the seven international companies owned more than 77 percent of the rest of the world's crude-oil-refining capacity.

Control of world cracking capacity.—Control over cracking capacity is potentially of greater economic significance than control over crude-refining capacity. The cracking process enables a refiner to obtain a greater quantity of higher-valued products (for example, gasoline as compared to residual fuel oil) from a given quantity of crude than can be obtained by the straight-run distillation method of refining. The cracking process also enables the refiner to vary the proportions of products produced, thus giving greater flexibility to the refining operation. Moreover, it is only by using cracking processes that the petroleum industry is able to produce high-octane gasoline and many of the chemicals which are the basic raw materials for synthetic rubber and many plastics. Thus the cracking process has made the petroleum industry an important supplier of products to other industries, and the concentration of control over the world's cracking capacity thereby affects a broader segment of the world economy than control over crude-refining capacity.

As will be seen from table 11, control of the world's cracking capacity is even more concentrated in the hands of the seven international petroleum companies than is control of crude refining. In 1950, these seven companies owned 47 percent of the cracking capacity of the United States, 53 percent of that of the Western Hemisphere, 84 percent of that of the Eastern Hemisphere, and 55 percent of that of the world. If the capacity of the United States and Russia (in-

[9] While 1949 data are used in a few cases in table 10, this does not alter the table significantly.

cluding her satellites) is excluded, these seven companies held 85 percent of all cracking capacity in the rest of the world, as compared with 77 percent of the crude-refining capacity of the same area.

TABLE 11.—*Capacity of cracking plants controlled by 7 international petroleum companies, 1950*

[In thousands of barrels daily]

Company	Western Hemisphere: United States	Western Hemisphere: Other Western Hemisphere	Western Hemisphere: Total	Total Eastern Hemisphere	Grand total
Anglo-Iranian Oil Co., Ltd.				137.5	137.5
Gulf Oil Corp.	237.9	7.3	245.2		245.2
Royal Dutch-Shell	248.3	186.9	435.2	83.4	518.6
Standard Oil Co. (N. J.)	464.2	386.3	850.5	25.3	875.8
Standard Oil Co. of California	191.5		191.5	15.7	207.2
Socony-Vacuum Oil Co., Inc.	347.4	1.3	348.7	15.5	364.2
The Texas Co.	383.0	32.5	415.5	15.7	431.2
Total, 7 companies	1,872.3	614.3	2,486.6	293.1	2,779.7
Total cracking capacity	3,980.0	716.7	4,696.7	[1] 348.3	[1] 5,045.0
Percent of total capacity, 7 companies	47.0	85.7	53.0	84.2	55.1

[1] Excluding capacity of U. S. S. R., Rumania, Hungary, and Poland.

Source: Data on individual company capacity in United States are from the Oil and Gas Journal, Mar. 23, 1950. Other data are from World Petroleum, annual refinery issue, vol. 21, No. 8, 1950.

Control of world petroleum transportation facilities.—In international trade petroleum and petroleum products are usually transported by tanker. Pipelines are important in areas where extended movements over land are necessary and feasible; but, outside the United States, this use is limited to moving crude petroleum from producing areas to refineries or water terminals. As with reserves, production, and capacity, petroleum transportation facilities outside the United States are also largely controlled by the seven petroleum companies.

At the end of 1949, Anglo-Iranian Oil Co., Ltd., reported that its subsidiary, British Tanker Co., operated 134 ships of about 1,400,000 dead-weight tons, and that additional tanker tonnage under various forms of charter amounted to about 2,000,000 dead-weight tons. In all, Anglo-Iranian directly employed some 14 percent of the world's tanker fleet.[10] Royal Dutch-Shell controlled and had under charter, at the end of 1949, more than 4,000,000 dead-weight tons.[11] Thus, between them, these two foreign companies owned or controlled approximately 30 percent of the world's tanker tonnage.

The five large American companies also operated large tanker fleets. Standard Oil Co. (New Jersey) owned 2,213,000 dead-weight tons at the end of 1949, exclusive of tonnage under charter and tonnage owned by nonconsolidated companies.[12] Gulf Oil Corp. owned 617,597 dead-weight tons, with an additional 311,074 tons under long-term charter;[13] in February 1948, Texas Co. controlled about 800,000 tons;[14] Standard Oil Co. of California, 552,000 tons;[15] nd Socony-Vacuum, about 467,000 tons,[16] not including tankers

[10] Annual Report to Stockholders, December 31, 1949, Anglo-Iranian Oil Co., Ltd.
[11] Royal Dutch Petroleum Co., Report for 1949.
[12] Annual Report 1949, Standard Oil Co. (New Jersey).
[13] Annual Report 1949, Gulf Oil Corp.
[14] The Petroleum Data Book, second edition, 1948.
[15] Ibid.
[16] Ibid.

under long-term charter. Although these data are not complete,[17] they show that the five American companies control about 5 million dead-weight tons, or more than 20 percent of the world's tanker fleet. Thus the seven international oil companies control at least 50 percent of the world's tanker fleet, and perhaps more, since most of the large oil companies have added substantial tonnage to their tanker fleets in 1950.

Actually, the use of the world's tanker fleet as a yardstick tends to understate the degree of concentration, since large tonnages are owned and controlled by governments or agencies of governments.[18] Therefore, a better yardstick would be the world's privately owned tanker fleet, which is estimated to have been between 18 and 19 million tons in 1948.[19] Since the seven large oil companies own or control about 12.4 million dead-weight tons, their percentage of control is about two-thirds of the total privately owned tanker fleet as compared to one-half of the world's total tanker tonnage.

It is noteworthy, too, that all of the important pipelines outside the United States are owned by the same seven oil companies. The principal petroleum pipelines abroad, and the corporate ownership of each, are shown in the following listing:[20]

1. The Oficina-Puerto la Cruz pipeline system in Venezuela consists of 99 miles of trunk line and 118 miles of gathering lines and is owned by Mene Grande Oil Co. (a Gulf subsidiary), and Creole Petroleum Corp. (a subsidiary of Standard Oil Co. (New Jersey)).

2. The Andian National's pipeline in Colombia is 335 miles long, and links the fields of Tropical Oil Co. with a marine terminal at Mamonal. The line is owned by Andian National Corp., Ltd., a subsidiary of International Petroleum Co., Ltd., which in turn is a subsidiary of Standard Oil Co. (New Jersey).

3. The South American Gulf Oil Co.'s line in Colombia extends 252 miles from Petroles in the Barco concession to the port of Covenas. Ownership of the South American Gulf Co. is divided equally between Socony-Vacuum Oil Co., Inc., and the Texas Co.

4. The Iraq Petroleum Co., Ltd., has a pipeline system which runs from the Kirkuk field in Iraq to Haifa and Tripoli on the Mediterranean Sea. The Kirkuk-Haifa lines are 621 miles long, and the Kirkuk-Tripoli lines are 532 miles in length. Iraq Petroleum Co., Ltd., as will be brought out later, is controlled by the large oil companies.

5. The Anglo-Iranian Oil Co. owns pipelines extending from producing fields in Iran to the Persian Gulf. There are several lines, and the total daily capacity of the system exceeds 500,000 barrels.

6. Recently completed by the Trans-Arabian Pipeline Co. is a 30–31-inch crude pipeline from Qaisuma, Saudi Arabia, to the

[17] Tonnage owned by some foreign subsidiaries and affiliates is probably not included. Also, long-term charter tonnage and the increase between February 1948 and the end of 1949 in the tonnage held by Texas, Socony, and Standard Oil of California would need to be included.

[18] Government-owned or controlled tonnage is of significance in this regard only where it is utilized in commercial traffic, and where it is not leased by the seven large oil companies, i. e., when it is made available to their competitors.

[19] Estimated from statistics in Petroleum Data Book, 1948.

[20] *Source:* Moody's Industrials, 1950; Petroleum Register, 1949; company Prospectuses and Annual Reports to Stockholders.

Mediterranean Sea, a distance of 753 miles. The line is owned by four American oil companies, as follows: Standard Oil Co. (New Jersey), 30 percent; the Texas Co., 30 percent; Standard Oil Co. of California, 30 percent; and Socony-Vacuum Oil Co., Inc., 10 percent.

7. In Venezuela, Creole Petroleum Corp., a subsidiary of Standard Oil Co. (New Jersey), in conjunction with one or more of the other large oil companies, operates a 143-mile crude-oil line, which extends from Lake Maracaibo in Venezuela to Amuay Bay on the Caribbean Sea.

8. The Bahrein Petroleum Co., Ltd., and the Arabian American Oil Co. jointly own a 34-mile crude line which connects the Dammam field of Saudi Arabia with a refinery on Bahrein Island. The Bahrein Petroleum Co., Ltd., is owned jointly by the Texas Co. and Standard Oil Co. of California, while Arabian American Oil Co. is owned 30 percent by Standard Oil Co. (New Jersey), 30 percent by Standard Oil Co. of California, 30 percent by the Texas Co., and 10 percent by Socony-Vacuum Oil Co., Inc.

9. The Sociedad Anonima Petrolera las Mercedes, which is owned jointly by the Texas Co. and Caracas Petroleum S. A., has a 157-mile crude line extending from producing fields in Venezuela to a deep-sea terminal at Pamatacual. Caracas Petroleum S. A. is controlled by British interests.

10. In Canada, Interprovincial Pipeline Co., Ltd., is constructing a crude line from Edmonton, Alberta, to Superior, Wis., a distance of about 1,100 miles. Interprovincial Pipeline Co., Ltd., is a subsidiary of Imperial Oil, Ltd., which, in turn, is owned by Standard Oil Co. (New Jersey).

11. In Venezuela, Creole Petroleum Corp. (a subsidiary of Standard Oil Co. (New Jersey)) and Shell Caribbean Petroleum Co. (of the Royal Dutch-Shell group) are cooperating in the installation of an 8-inch products line from the seacoast of Catia la Mar to Caracas.[21]

In addition to the above lines, Middle East Pipelines, Ltd., has proposed the construction of a large crude-oil pipeline from Iran to the Mediterranean Sea. Middle East Pipelines, Ltd., is owned 60.9 percent by Anglo-Iranian Oil Co., Ltd.; 24.7 percent by Standard Oil Co. (New Jersey); and 14.4 percent by Socony-Vacuum.

Thus, outside of the United States, every important pipe line in existence or even proposed is controlled by the seven principal international oil companies, individually or jointly.

Control over marketing.—Perhaps in no other raw material industry is the control over marketing so highly concentrated as in petroleum. All seven of the large international companies market, either jointly or severally, petroleum products through various subsidiaries and affiliates in all important consuming areas of the world except the U. S. S. R. and its satellite countries. Each of the major petroleum companies is integrated, from crude production through refining, transportation, storage terminals, and docks, to wholesale and retail distributing and dispensing equipment. It is the rule, rather than the exception, for petroleum products to move from producer to consumer by company-owned facilities within one corporate hierarchy.

[21] World Petroleum, April 1950, p. 63.

While a detailed analysis cannot be given, due to the scarcity of statistical information, it would appear that the seven international oil companies are dominant forces in nearly all foreign markets. Illustrative examples of their control of the market in the 1930's are given in the case studies of marketing arrangements in chapter IX, not only in such important markets as the United Kingdom and France but also in such lesser markets as Norway, Chile, and Jamaica. This control of particular marketing areas in all parts of the world would appear to have continued into the post-World War II period.[22]

In any event it does not appear necessary to develop any elaborate statistical argument to support the conclusion that the seven international oil companies have a highly concentrated control over marketing. Such control would seem to be inevitable for the simple reason that there are no other companies operating in international markets capable of supplying petroleum products in substantial quantities, as has been amply suggested by the information given in this chapter on all divisions of the petroleum industry. Upon the secure basis of their control over production, refining, and transportation, the seven international oil companies have built extensive marketing organizations reaching into consuming areas in all parts of the world. The power of these major companies is so substantial as to be virtually unchallengeable, except, perhaps, in particular local marketing areas.

IMPORTANCE OF INTERCORPORATE RELATIONSHIPS IN THE INTERNATIONAL OIL INDUSTRY

In the preceding sections, data were presented showing the extent to which the international petroleum industry is owned and controlled by seven large companies. The influence of these companies on the world's oil business is increased by close corporate relations existing between them.

Joint ownership of subsidiary and affiliated companies.—Outside the United States, Mexico, and Russia, the operations of the seven international petroleum companies are combined through various intercompany holdings in subsidiary and affiliated companies. These holdings constitute partnerships in various areas of the world. Each of the companies has pyramids of subsidiary and affiliated companies in which ownership is shared with one or more of the other large companies. Such a maze of joint ownership obviously provides opportunity, and even necessity, for joint action. With decision-making thus concentrated in the hands of a small number of persons, a common policy may be easily enforced.

The principal foreign companies jointly owned at the end of 1949 by two or more of the seven international oil companies are shown[23] on

[22] While only limited data on marketing operations of the major oil companies in the post-World War II period are available, data for Brazil throw some light on the extent of market dominance. In 1936, according to records of the Standard Oil Co. (New Jersey), three of the international oil companies—Standard (New Jersey), Royal Dutch-Shell, and Texas Co.—together with the Atlantic Refining Co., controlled the following proportions of the principal products marketed in Brazil: Gasoline, 98 percent; kerosene, 91 percent; fuel oil, 100 percent; gas and Diesel oil, 99 percent; and asphalt, 99 percent. In the postwar period, it was estimated that these companies and the Gulf Oil Corp. held about 100 percent of the combined markets for all petroleum products in Brazil. The respective shares of the companies were approximately as follows: Standard (New Jersey), 39 percent; Royal Dutch-Shell, 17 percent; Texas Co., 14 percent; Gulf, 4 percent; and Atlantic, 26 percent. Although not indicated, it would appear that the data given are for 1949; World Petroleum, June 1950, p. 41.

[23] Sources: Moody's Industrials, 1950; company Prospectuses and Annual Reports to Stockholders, 1949–50; World Oil, 1949–50; World Petroleum, 1949–50; Petroleum Register, 1949; and The Oil and Gas Journal, 1950.

the accompanying charts for the Middle East, Europe, Latin America, the Far East, and the United States and Canada.

To summarize briefly, the principal facts revealed by these charts are the clusters or complexes of corporate interrelations effected through jointly-owned subsidiaries and affiliates. For example, in the Middle East, Jersey Standard, Socony, Royal Dutch-Shell, and Anglo-Iranian are linked through their joint holdings in Iraq Petroleum Co. and its nest of subsidiaries; Gulf and Anglo-Iranian jointly own Kuwait Oil; Standard of California and Texas Co. have many joint relations through the California-Texas complex of companies and are tied to Jersey Standard and Socony through Arabian American Oil Co. and Trans-Arabian Pipe Line Co.

In Europe, again there is the California-Texas cluster of companies linking together Standard of California and Texas Co.; Anglo-Iranian, Royal Dutch-Shell, Socony, and Jersey Standard jointly own Companhia Africana de Petroleo; while Gulf and Jersey Standard are tied through their holdings in United Petroleum Securities Corp. In Latin America, a major complex of holdings links Socony, Standard of California, and Texas; while another brings together Jersey Standard, Gulf, and Royal Dutch-Shell.

The most important single complex in the Far East is the combination of Jersey Standard, Socony, Texas, Standard of California, and Royal Dutch-Shell through N. V. Nederlandsche Nieuw Guinee Petroleum Maatschappij. The California-Texas combine also operates in the Far East, as does Standard-Vacuum, which is one of the important companies linking together Jersey Standard and Socony-Vacuum; and Anglo-Iranian and Royal Dutch-Shell jointly conduct extensive operations in the Far East as well as Europe.

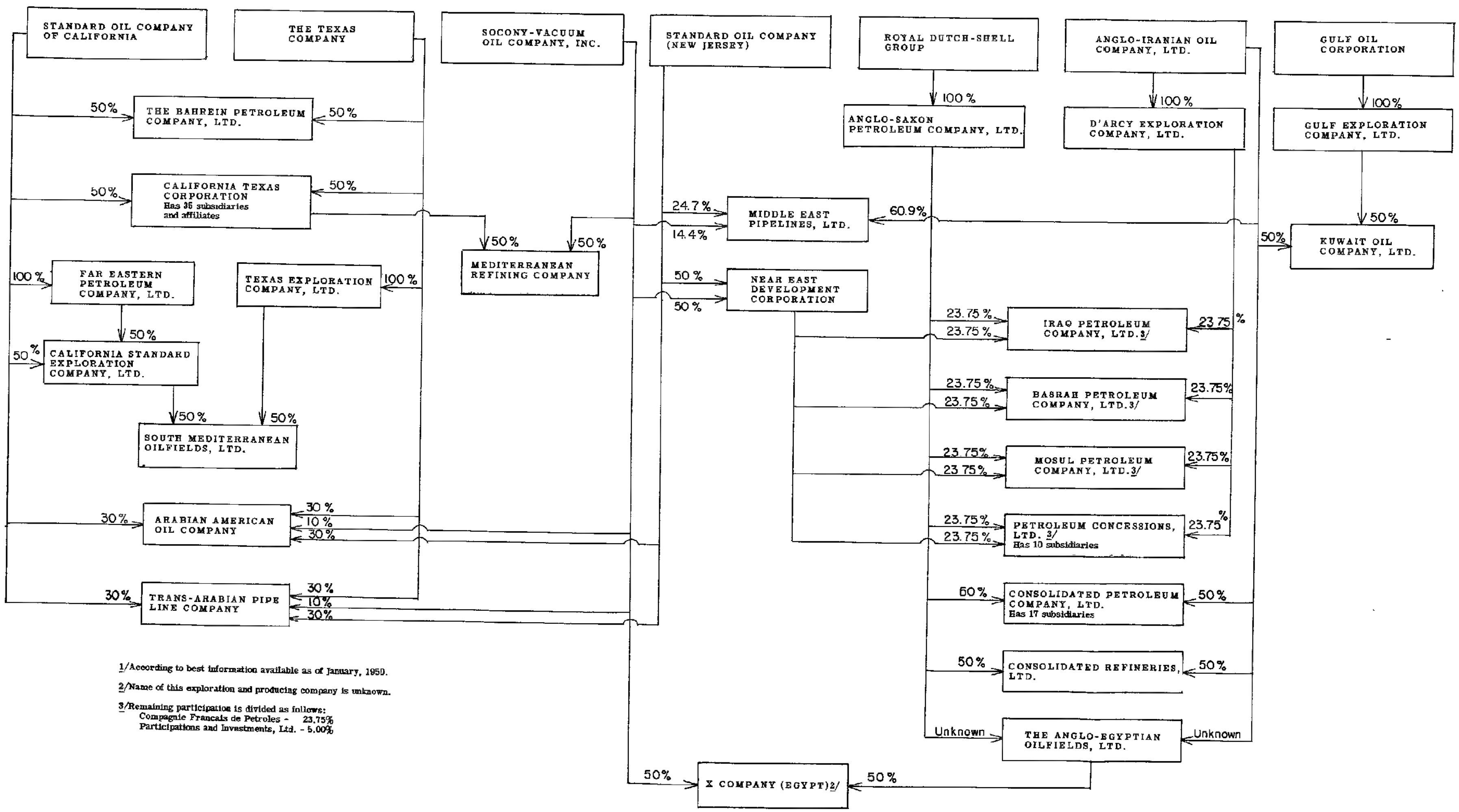
The principal international companies also conduct many joint operations in the United States and Canada, and have established a corporate network of joint holdings with major domestic oil companies. These interconnections are primarily through jointly owned pipe lines, technical processing and licensing companies. The Texas Co., for instance, through its share holdings in Great Lakes Pipe Line Co., is connected with seven important domestic oil companies. Shell Oil Co., owned by the Royal Dutch-Shell group, shares ownership in the Bayou Pipe Line System with Jersey Standard and four domestic oil companies. The Texas Co., Pure Oil, and Standard of Indiana jointly own Gray Process Corp.; Jersey Standard and Standard of California have a joint exploration venture in Canada, while Socony, Texas Co., and Standard of Indiana are linked through their joint ownership of Wyco Pipe Line Co.

The joint-ownership companies shown on the above charts by no means represent an exhaustive listing; nor do they necessarily include all the important joint ownerships. It has not been possible to compile a complete list. However, the indicated joint-ownership relations are sufficient to show that the international oil companies are not only interlocked in their operations in the United States and Canada, but also are engaged in joint operations with many other large domestic oil companies.

These intercorporate relations are important in that they expand the area of potential control that may be exercised by the seven international oil companies. But also important is the type of company through which the joint-ownership relations are effected. The fact

CHART 13.

JOINT OWNERSHIPS BY INTERNATIONAL OIL COMPANIES OF SUBSIDIARY AND AFFILIATED COMPANIES IN THE MIDDLE EAST 1/



1/According to best information available as of January, 1950.

2/Name of this exploration and producing company is unknown.

3/Remaining participation is divided as follows:
Compagnie Francais de Petroles - 23.75%
Participations and Investments, Ltd. - 5.00%

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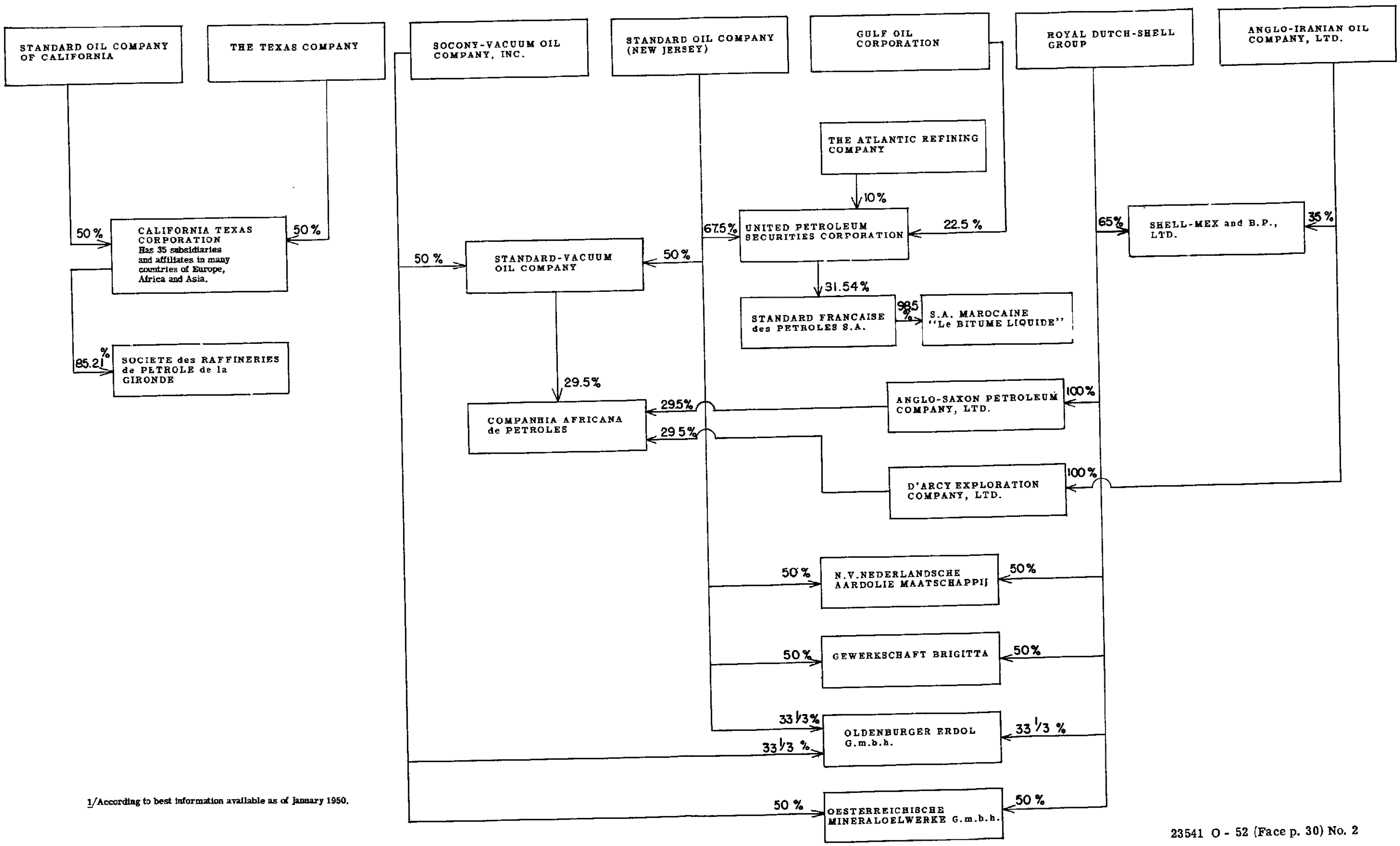
CHART 14.

JOINT OWNERSHIPS BY INTERNATIONAL OIL COMPANIES OF SUBSIDIARY AND AFFILIATED COMPANIES IN EUROPE 1/



1/ According to best information available as of January 1950.

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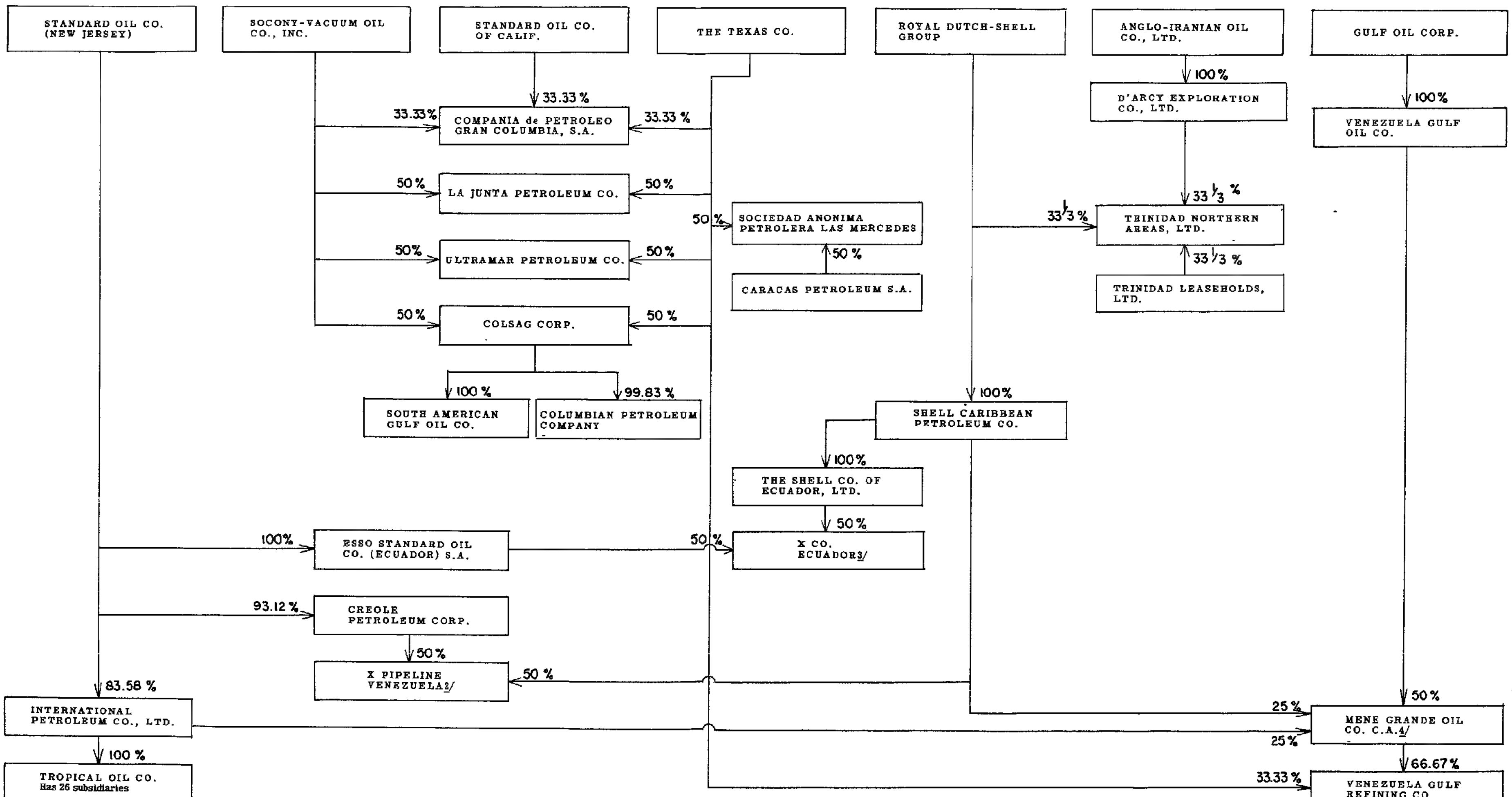
Approved For Release 2010/04/14 : CIA-RDP57-00384R000700130001-2

CHART 15.

JOINT OWNERSHIPS BY INTERNATIONAL OIL COMPANIES OF SUBSIDIARY AND AFFILIATED COMPANIES IN LATIN AMERICA 1/



1/According to best information available as of January, 1950.
2/Company is to install an 8-inch products line from the seacoast at Catia La Mar to Caracas. Name of the company is unknown.
3/Company holds a 12-million acre concession. Name is unknown.

4/The Gulf Oil Company owns 100% of the shares of stock in the Mene Grande Oil Company and the percentage interests shown in the chart represent undivided interests in the properties owned and the oil produced by Mene Grande. The Mene Grande Oil Company owns a two-thirds interest in the Oficina-Puerto la Cruz pipeline system and the Creole Petroleum Corporation, a subsidiary of the Standard Oil Company (N.J.) owns a one-third interest.

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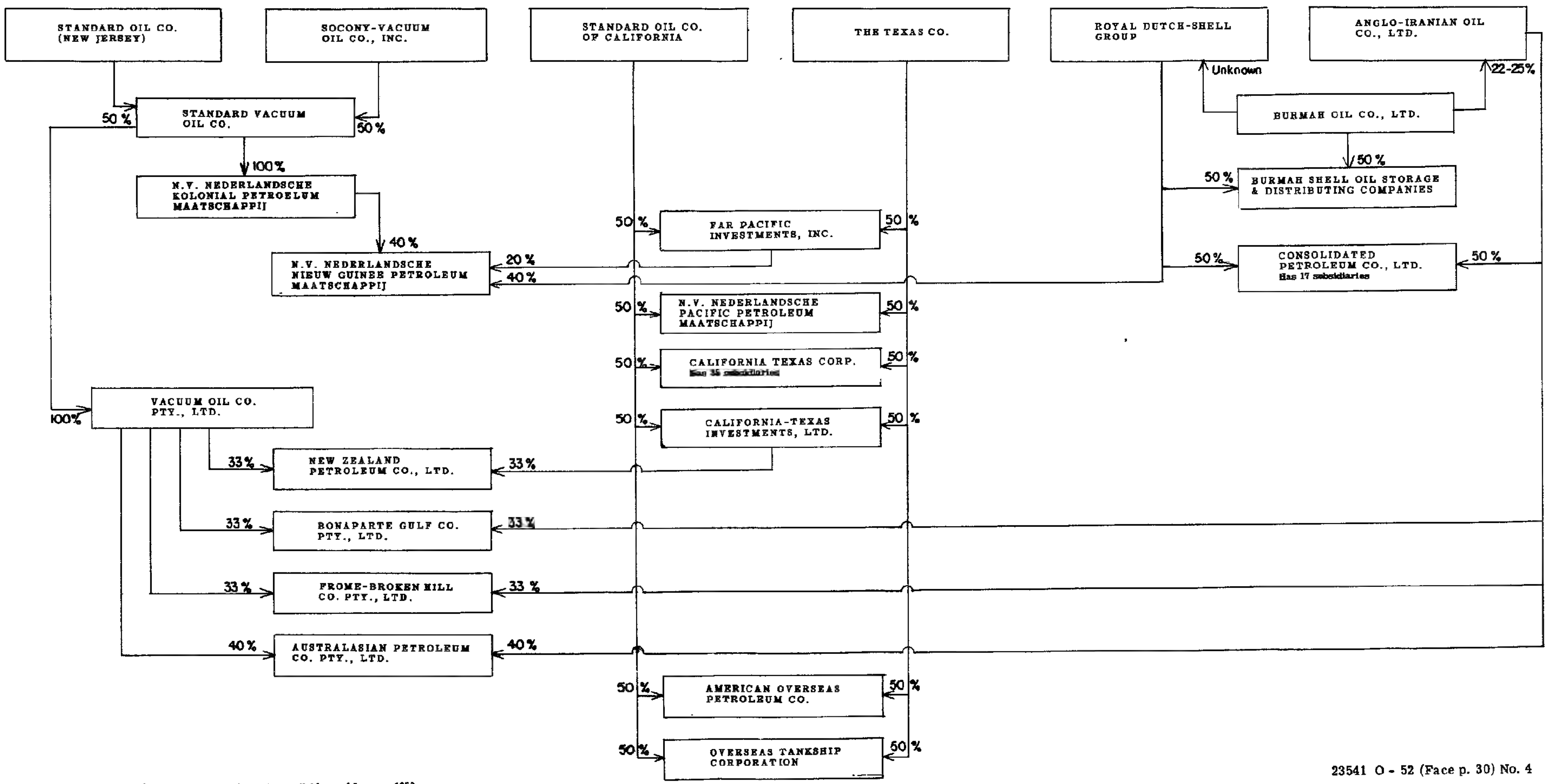
CHART 16.

JOINT OWNERSHIPS BY INTERNATIONAL OIL COMPANIES OF SUBSIDIARY AND AFFILIATED COMPANIES IN THE FAR EAST [1/]



1/According to best information available as of January, 1950.

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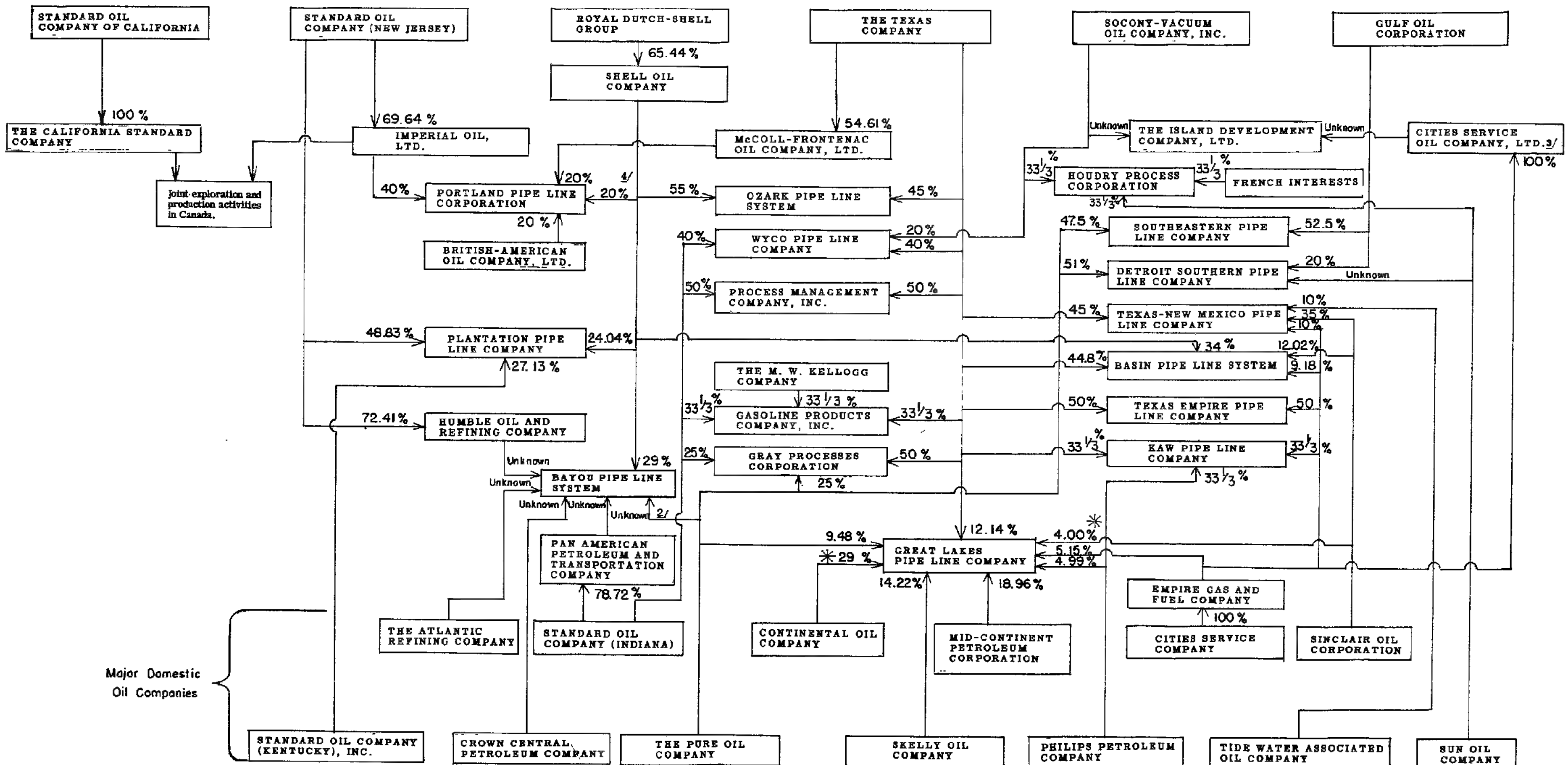
CHART 17.

JOINT OWNERSHIPS BY INTERNATIONAL AND MAJOR DOMESTIC OIL COMPANIES OF SUBSIDIARY AND AFFILIATED COMPANIES IN THE UNITED STATES AND CANADA 1/



*Approximately

1/According to best information available as of January, 1950.

2/The Pure Oil Company through a wholly-owned subsidiary owns a 14.64% interest in a segment of the Bayou Pipe Line System.

3/The Cities Service Company's holdings in The Island Development Company, Ltd., are probably held through the subsidiaries shown on the chart, but this is not definitely known.

4/Shell's interest in Portland Pipe Line Company is held by the Shell Oil Company of Canada, Ltd., which is owned 50 percent by the Shell Oil Company and 50 percent by the latter company's parent, Shell Caribbean Petroleum Company.

Notes: The Texas Company also owns a 41.51% interest in Carthage Hydrocol, Inc., a company in the synthetic gasoline business, the remaining interests being held by a number of other companies, including a subsidiary of Socony-Vacuum.

World Oil, July 15, 1950, reports two Canadian syndicates jointly owned as follows:

1. Home Brazeau Syndicate - Home Oil Company, Ltd., Anglo-Canadian Oil Company, Ltd., Imperial, Shell, Socony-Vacuum, and California Standard.
2. Muskeg Syndicate - Gulf, Shell, Imperial, Socony-Vacuum, and McColl Frontenac.

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that pipeline companies and companies concerned with patents and technological processes are common among the jointly owned companies is not without significance. Technology and transportation are strategic points in the oil industry for exerting the maximum of control.

Interlocking directorates among the international petroleum companies.—The boards of directors that manage the labyrinth of foreign corporations, which are jointly owned by the major international oil companies, provide organizational opportunities for joint action and the establishment of a common oil policy throughout the world. Of course, not all interlocking directorates are significant; some may be fortuitous. Nonetheless the fact that they exist on such a widespread scale in the petroleum industry makes it possible for a small group of individuals to exercise unusual influence on the industry's operations and behavior. A few examples of the more important directorships held by various key individuals, in 1949, will illustrate the manner in which a thread of interconnections is woven by directorates between the major companies.[24]

As an example of a common "meeting ground," the board of directors which determines the policies of the Arabian American Oil Co. (Aramco) is composed of three members each from the boards of the Standard Oil Co. (N. J.), Standard Oil Co. of California, and Texas Co.; one member from the board of Socony-Vacuum Oil Co., Inc., and one member with no listed affiliation.[25]

The extent of the interlocking directorships among the major oil companies is indicated on chart 18. This chart reveals that a considerable number of the directors of the international companies hold multiple directorships in subsidiary companies. For example, the directors of Standard of New Jersey and Socony-Vacuum, who determine the policies of Arabian American Oil Co., are the same men who help to shape the behavior of Iraq Petroleum Co. The directors of Anglo-Iranian who assist in making high oil policy for Iraq and Iran, participate, along with the directors from Gulf, in planning the price and production policies of Kuwait. It must be kept in mind that the chart shows only the directorships in Middle East subsidiaries held by directors of the parent companies and, because they are directors of the parent companies, these same individuals are able to influence decisions with respect to operations in the Far East, Europe, Venezuela, and the United States.

Chart 19 shows some of the indirect interlocking relations between international oil companies operating in the United States and some major domestic companies. Thus directors of Standard of California interlock through intermediate corporations with directors of the Union Oil Co. of California (in four cases), of the Standard Oil Co. (Indiana), and of the Continental Oil Co. Directors of the Gulf Oil

[24] The information on directors, named in this section, was obtained from Poor's Register of Directors and Executives, 1950; Minutes of Meetings of Boards of Directors of Iraq Petroleum Co., Ltd., Trans-Arabian Pipe Line Co., Arabian American Oil Co., and Middle East Pipe Lines, Ltd., 1949; Petroleum Register, 1949; company prospectuses and annual reports to stockholders, 1949–50; and Moody's Industrials, 1950.

[25] In 1949, the following individuals served on the board of directors of Arabian American Oil Co.: S. P. Coleman, director, Standard Oil Co., (N. J.); Orville Harden, director, Standard Oil Co. (N. J.); John Suman, director, Standard Oil Co. (N. J.); H. D. Collier, director, Standard Oil Co. of California; R. G. Follis, director, Standard Oil Co. of California; B. W. Letcher, director, Standard Oil Co. of California; W. S. S. Rodgers, director, the Texas Co.; A. C. Long, director, the Texas Co.; H. T. Klein, director, the Texas Co.; C. L. Harding, director, Socony-Vacuum Oil Co., Inc.; and W. F. Moore, president of Aramco; his other affiliations, if any, are not know.

Ownership of Arabian American Oil Co. and Trans-Arabian Pipe Line Co., is divided between Jersey Standard, Texas, Standard of California (each holding a 30-percent share), and Socony-Vacuum (a 10-percent interest).

Corp. interlock with directors of the latter two companies and with directors of the Pure Oil Co., Panhandle Producing & Refining Co., Tidewater Associated Oil Co., Phillips Petroleum Co., and Shamrock Oil & Gas Corp. Interlocking relations similarly exist between directors of Shell Oil Co. and Texas Co. and directors of many domestic oil companies. These indirect relations provide opportunities for the international companies to harmonize any conflicting interests that might develop between the international companies and major domestic companies. It is an organizational device that could be used in the event it was needed.

As will be noted from the charts, Standard Oil of New Jersey and Socony-Vacuum are the only two major international companies operating in the United States which did not have interlocking relations with other oil companies. Both of these firms, however, conduct many domestic as well as foreign operations on a partnership basis among themselves and with other oil companies.[26]

These relationships by no means exhaust the interlocking directorates existing in the petroleum industry, since they do not include directorships of the subsidiary and affiliated companies, both foreign and domestic, controlled by the seven international companies. But since most of the oil business outside the United States is conducted directly or indirectly by the seven major companies themselves, the expansion of their area of potential influence through interlocking relations with other oil companies is limited primarily to companies operating in the United States.

SUMMARY

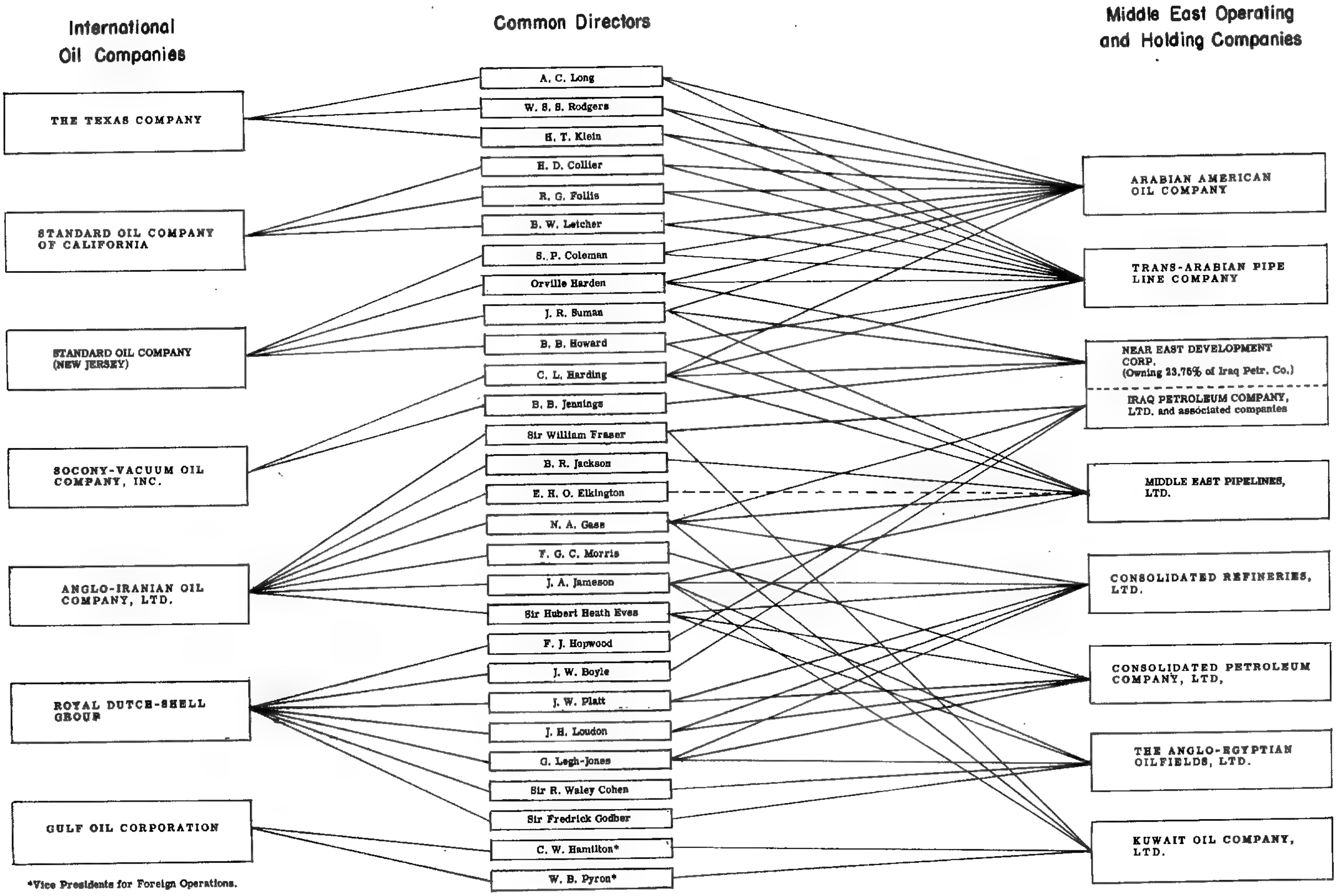
The international oil industry, in a physical sense, is composed of four distinct and separate divisions: production (and exploration), transportation, refining, and marketing. However, by vertical integration, the operations in all divisions are performed by large integrated companies.

Control over the international oil industry is largely in the hands of seven integrated companies. Outside the United States and the Soviet Union, they control the bulk of production and marketing of oil moving in international commerce. Many pairings and groupings of these seven companies and their affiliates conduct joint operations in most parts of the world. Four of them own over 70 percent of the shares of Iraq Petroleum Co., Ltd., which, in turn, controls all the oil of Iraq, Qatar, the Trucial coast, and other less important areas in the Middle East; four of them own all the shares of Arabian American Oil Co., which controls all the oil in Saudi Arabia, and two of these four own the Bahrein Petroleum Co., Ltd., which, in turn, controls the oil resources of Bahrein Island; one has exclusive control of all the oil in Iran, and in partnership with another of the seven companies, controls all the oil in Kuwait; three of the seven, in partnership and in separate operations, control most of the oil resources of Venezuela and other Latin-American countries, except those with state monopolies; five of them, operating as three corporate entities, control most of the oil resources of the Netherlands East Indies.

[26] See preceding section on "Operations of jointly owned affiliates and subsidiaries."

CHART 18.

INTERLOCKING DIRECTORATES AMONG INTERNATIONAL OIL COMPANIES IN THE MIDDLE EAST [1/]



*Vice Presidents for Foreign Operations.

Broken line represents alternate directorships.

Notes: This chart was prepared as of January 1, 1950, except for the following: A. C. Long was listed as a director of The Texas Company in the Annual Report for 1950 of the Company, but the effective date of the appointment was not given; the directors of the Trans-Arabian Pipe Line Company are given as of January 18, 1949, the last date for which this information was available to the Commission.

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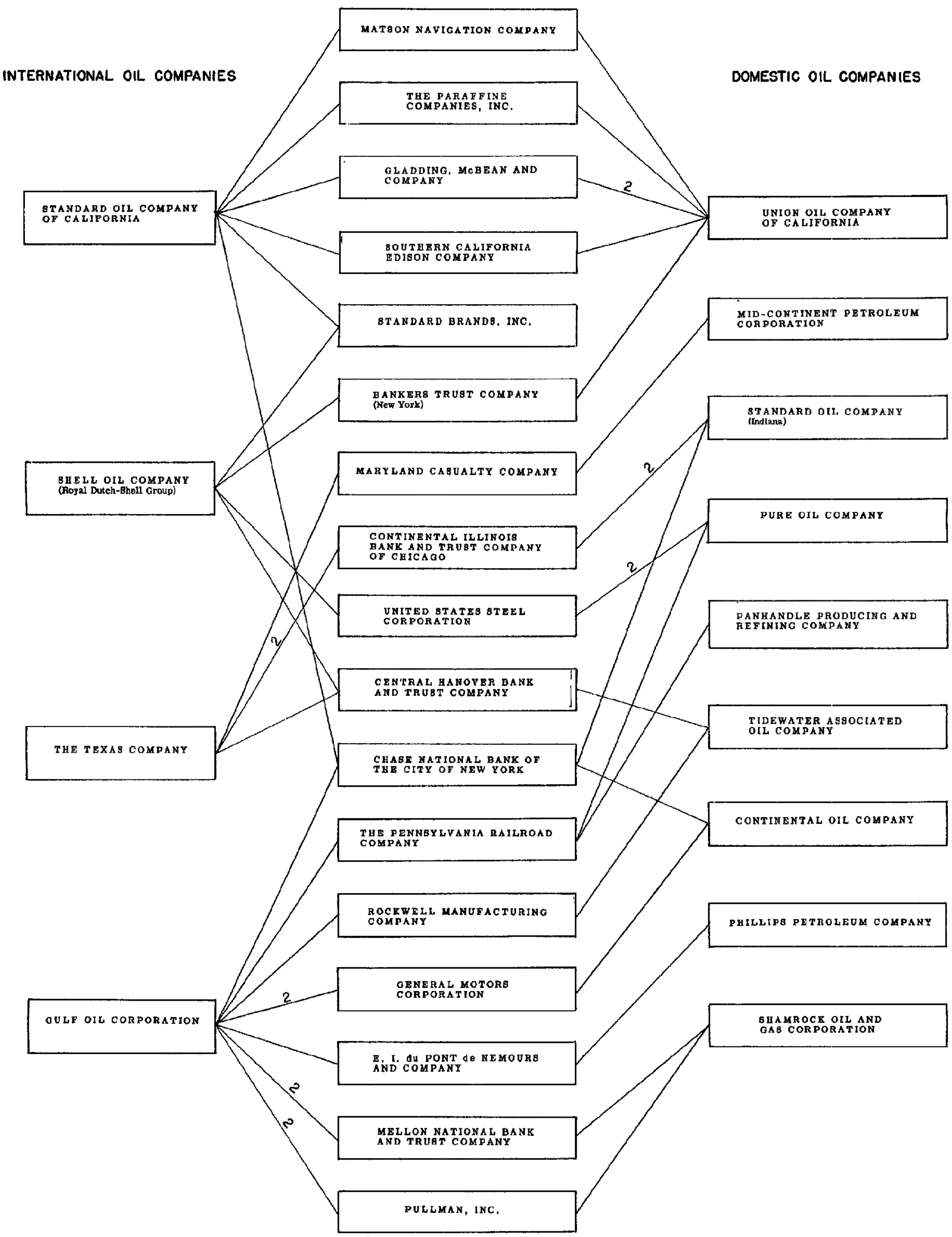
CHART 19

RELATIONSHIPS BETWEEN INTERNATIONAL OIL COMPANIES AND MAJOR DOMESTIC OIL COMPANIES THROUGH INDIRECT INTERLOCKING DIRECTORATES [1]



1/As of January, 1950.

Notes: In cases where there are more than one interlocking directorate, the appropriate number is shown.
Interlocking directorates among major domestic oil companies not having important international interests are excluded from this chart. For examples of such interlocks, see the Report on Interlocking Directorates, Federal Trade Commission, 1951, Chapter 12.

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These seven international companies operate through layers of jointly owned subsidiaries and affiliated companies. Through this corporate complex of companies, they control not only most of the oil but also most of the world's foreign petroleum refining, cracking, transportation, and marketing facilities. Thus, control of the oil from the well to ultimate consumer is retained in one corporate family or group of families.

Joint ownership of affiliated companies is probably more widespread in the international petroleum industry than in any other field of enterprise. The major international oil companies use the joint-ownership technique not only in conducting foreign operations but also in their operations in the United States and Canada. This is particularly true with respect to control of pipe lines and companies holding patents on technological processes. Thus, the international companies, operating in the United States and Canada, are joined with the large domestic oil companies in the two operations where control is likely to exert the maximum of influence on the industry.

Also, the boards of directors that manage the myriad of jointly owned corporations may, in effect, be private planning boards where differences are resolved and where an oil policy for the world can be established. Under any circumstances, it would be difficult to overlook the significance of the meeting together of directors of the major international oil companies to determine the price and production policies of companies whose operations must inevitably affect the oil industry throughout the world.

Control through the joint-ownership device is further centralized and unified by the fact that directors of the major companies also serve as directors of some of the more important affiliated companies. This close association of policy-making officials can readily result in a unified management of the various combinations of interests, and thus tends to lessen the opportunity for effective competition between the major companies in their foreign operations.

The international companies have also extended their spheres of potential influence over the United States oil industry through indirect interlocking directorates. Although the association of the directors of the international companies with the directors of important domestic oil companies on the board of a third company may not be significant in and of itself, it at least provides the opportunity for reconciling differences that may arise between the international and the domestic companies.

The significance of this high degree of concentration for the cartel problem lies in the fact that concentration facilitates the development and observance of international agreements regarding price and production policies. Indeed, the concentration of an industry into a few hands may be regarded as the sine qua non of effective cartel operations.

PART II

DEVELOPMENT OF JOINT CONTROL OVER THE INTERNATIONAL PETROLEUM INDUSTRY

CHAPTER III

DEVELOPMENT OF JOINT CONTROL OVER FOREIGN OIL

INTRODUCTION—BACKGROUND OF INTEREST IN FOREIGN OIL

Part I of this report described the areas of world production and reserves and analyzed the extent of control of petroleum reserves, production, refining, transportation, and marketing. Part II presents a more detailed analysis of the growth of concentration in the principal foreign producing areas—the Middle East and Venezuela. This concentration has been effected largely through the twin instruments of joint-ownership and crude-oil-supply contracts. The history and development of concentration in the Middle East, which is of particular interest because of its importance to future supply (and thus to future price and production behavior), is described in chapters IV, V, and VI. In chapter VII, an examination is made of the development of control in Venezuela, a country which will undoubtedly continue to be a principal source of supply to the world petroleum industry.

Before examining the development of concentration, however, it is important to describe briefly the forces which led the major oil companies to seek control of foreign petroleum reserves.

Prior to the early twenties the major oil companies tended to fall into one of two classes with respect to their policies concerning foreign reserves. On the one hand were the concerns which for many years had based their operations on the control of reserves and the production of crude oil. On the other hand were the firms which had achieved their prominence as refiners and distributors, owning few reserves and producing little crude.

As a striking example of the former type, Royal Dutch-Shell had based its growth primarily on control of reserves and production in the Dutch East Indies, where oil was discovered about 1890.[1] In order to market its crude oil, it developed refineries, transportation, and marketing facilities, both where its surplus-producing reserves were located, and in importing countries which either had no crude oil or were deficit producers. Likewise, what is now the Anglo-Iranian Oil Co., Ltd., began in 1901 as a concession granted to William D'Arcy. Anglo-Iranian Oil Co. was formed in 1909 to acquire this concession, which was revised in 1933 to cover a total of 100,000 square miles.

The outstanding example of the latter type of concern is the Standard Oil Co. and its successors. When first incorporated in 1870, it was strictly a refining company, controlling only about 10 percent of the petroleum refining capacity of the United States and operating altogether on crude oil purchased from others. In 1873, it first engaged

[1] The present Royal Dutch Petroleum Co. was incorporated in 1890 as Royal Dutch Co. for the working of petroleum wells in the East Indies. At that time it was a local Indonesian enterprise (Moody's Industrials, 1950, p. 2107).

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in pipeline gathering and transportation of crude bought from others. By 1879, it had increased its control of refining capacity to 90 percent of the total in the United States.[2] In 1887, it had entered the field of production in a small way, with two subsidiaries classed as crude-oil producers. Thereafter, its interest in all four functions of production, refining, transportation, and marketing increased, but the principal basis for its growth in both domestic and foreign markets was its control of transportation, refining, and marketing. In 1904, it produced no more than one-sixth of total United States crude-oil production, but refined and marketed through its own selling organization seven-eighths of all crude run through United States refineries.[3]

Since the United States was the world's largest producer of crude and refined products for export at the turn of the century, Standard's dominance in domestic transportation, refining, and marketing also carried with it a dominant position in international trade in crude oil and its refined products. The company's ability to attain and maintain that position without extensive control of reserves or actual production was favored by the periodic discovery of new oil fields which kept domestic production at such high levels as to create a surplus for export throughout the first 35 years of the company's history.[4]

Around the early twenties, however, an entirely new set of factors led the Standard Oil companies to reverse their traditional policy of disinterestedness in foreign reserves. These new factors may be summarized as follows:

Fear of an oil shortage in America.—The vital role of oil in a modern industrial economy had vividly been brought home to the American people by World War I. Immediately thereafter, there developed a deep-seated fear that the United States was running out of oil. An oil industry source described the prevailing pessimism in the following words:

> Fear of an oil shortage in the United States was uppermost as a factor in international relations after World War I. It was a hold-over fear from a narrow escape from scarcity in 1917–18 when in the midst of war. It was fanned by what might have been an actual—although probably short-lived—shortage had the war, with its tremendous demands on American supplies, been prolonged into 1919 and 1920. That it grew into a case of national jitters is not wholly surprising in view of the fact that the military importance of oil in modern war had been demonstrated. Oil supply took on a vital national defense complexion.[5]

This pessimistic point of view during 1918–24 was backed up by estimates, which at the time were regarded as expert. In October

[2] Commissioner of Corporations, Report on the Petroleum Industry, pt. 1, Position of Standard Oil Co. (1907), pp. 48 and 51.

[3] Ibid., pp. 1 and 8.

[4] According to Twentieth Century Petroleum Statistics (DeGolyer and MacNaughton, 1949), the proportions of world crude oil produced in the United States at 5-year intervals from 1900 to 1945 and for the year 1948 were as follows:

	Percent of United States		*Percent of United States*
1900	42.7	1930	63.6
1905	62.6	1935	58.4
1910	63.9	1940	62.9
1915	65.1	1945	66.0
1920	64.3	1948	59.2
1925	71.4		

[5] It appears that this same fear of an oil shortage, either real or imaginary, regularly manifests itself after every war and during periods of national emergency. See American Petroleum Interests in Foreign Countries, hearings before a Special Committee Investigating Petroleum Resources, pursuant to S. Res. 36, 79th Cong., 1st sess., 1945.

1919, Dr. Van Manning, Director of the United States Bureau of Mines, stated:

> We thus see domestic oil fields unable to meet our home demands under present methods of utilization and manufacture.[6]

In January 1920, Dr. George Otis Smith, Director of the United States Geological Survey, in commenting upon our oil supply stated:

> The position of the United States in regard to oil can best be characterized as precarious.[7]

In May 1920, Dr. Smith said:

> Americans will have to depend on foreign sources or use less oil, or perhaps both.[8]

In 1920, David White, of the United States Geological Survey, stated:

> On the whole, therefore, we must expect that, unless our consumption is checked, we shall by 1925 be dependent on foreign oil fields to the extent of 150,000,000 barrels and possibly as much as 200,000,000 of crude each year, except insofar as the situation may at that time, perhaps, be helped to a slight extent by shale oil. Add to this probability that within 5 years—perhaps 3 years only—our domestic production will begin to fall off with increasing rapidity, due to the exhaustion of our reserves * * *[9]

During the period 1919–22, imports of crude oil from Mexico had been large—equal to 22 percent of total United States consumption in 1921.[10] But salt water began to appear in some Mexican wells, and by 1921 geologists were debating whether Mexican production was not "through." In commenting upon the Mexican situation, David White of the United States Geological Survey said:

> A great slump in Mexican production * * * seems sooner or later inevitable.[11]

Thus, there was not only alarm about the United States oil potential but also about our primary foreign source of supply. Lending encouragement to these doubts were statements appearing in foreign publications describing the United States oil position. E. Mackay Edgar, in Sperling's Journal for September 1919, wrote:

> The time * * * is, indeed, well in sight, when the United States * * * will be nearing the end of some of its available stocks of raw materials on which her industrial supremacy has been largely built * * * America is running through her stores of domestic oil and is obliged to look abroad for future reserves * * *[12]

Again in 1921 Mr. Edgar stated:

> * * * given a resumption of trade and the consequent demand for oil products in, at the most, a year or two, the world will be confronted with an oil shortage such as has never been experienced before * * *[13]

High cost of purchasing private mineral rights in America.—In the United States, the law reserves to the owner of land the right to own, exploit, or dispose of minerals underlying the surface owned. Only where oil-bearing lands are part of the public domain is it possible to negotiate with the Government for large-scale territorial concessions.

[6] Ibid., p. 299; reprinted from National Petroleum News, October 29, 1919.
[7] Ibid., p. 249; reprinted from New York Times, January 1, 1920.
[8] Ibid., p. 299; reprinted from National Petroleum News, May 5, 1920.
[9] David White, the Annals, "The Petroleum Resources of the World," May 1920, p. 121.
[10] John Ise, United States Oil Policy, p. 454.
[11] American Petroleum Interests in Foreign Countries, p. 301; reprinted from Engineering and Mining Journal, March 18, 1922, p. 455.
[12] Quoted from The Annals, May 1920, p. 132.
[13] American Petroleum Interests in Foreign Countries, p. 300; reprinted from Sperling's Journal (London), August 1921, p. 30. For a different viewpoint with respect to the oil shortage of this period, see ch. 10 and appendix II of E. H. Davenport and S. R. Cooke, The Oil Trusts and Anglo-American Relations, 1924.

As oil-bearing lands which were part of the public domain became less and less important as a source of supply, it became necessary to lease or purchase private mineral rights on a large scale, and often at high cost, if large reserves were to be acquired and held for the future.

This economic factor was of importance not only because of the fear of a prospective oil shortage in the United States, but also because this meant that American oil would be at an increasing disadvantage in supplying foreign markets. These markets at that time were developing rapidly due to the growth of motor transportation and the use of petroleum products for power, light, heat, and other uses. Particularly important in foreign markets was the growth in demand for bunker oils, since, following the lead of the British Navy in 1912, much of the world's shipping fleets were being converted from coal to fuel oil as their source of power.

Discovery of foreign reserves.—After 1890, the discovery and development of new fields in foreign countries, such as those of Rumania, India, Dutch East Indies, and Iran, gave the concession owners, chiefly British-Dutch interests, supplies of crude oil more advantageously located, freightwise, with respect to foreign consuming markets than the oil fields of the United States and Mexico. The economic advantages accruing to companies with widely distributed sources of supply, such as Royal Dutch-Shell,[14] is obvious. American companies wishing to retain European and Asiatic markets for their products at costs comparable to those of other suppliers could do so only by obtaining foreign reserves for themselves.

Fear of foreign monopoly.—Concurrent with the fear of an oil shortage in the United States and with the development of these economic factors unfavorable to American oil companies interested in foreign markets, there was also developing a general fear of a foreign monopoly of all foreign oil resources. In 1920 and 1921, the United States Senate demanded an investigation of the restrictions imposed on American citizens by foreign countries in prospecting for petroleum and of the steps being taken to remove these restrictions.[15] From the resultant reports and investigations it was concluded that American interests were being systematically excluded from foreign oil fields. In May 1920 Senator Phelan of California introduced a bill under which a Government corporation would be established to develop oil resources in foreign countries.[16]

The rapid expansion of Royal Dutch-Shell in the United States during 1919 and 1920 was pointed out as an illustration of the exploitation by a foreign company of American resources, while conserving reserves elsewhere.[17] A statement was circulated among American oil companies in August 1919, to the effect that the British Government had decided to use the Shell organization to develop the oil resources of the British Dominions.[18] Resentment and indignation

[14] In 1921, Royal Dutch-Shell drew its supplies of crude from 8 countries. It had 120 bunkering stations in all parts of the world. Federal Trade Commission, Report on Foreign Ownership in the Petroleum Industry, 1923, pp. 16, 20.

[15] S. Doc. No. 272, 66th Cong., 2d sess.; S. Doc. No. 39, 67th Cong., 1st sess.

[16] S. 4396, 66th Cong., 2d sess.

[17] John Ise, The United States Oil Policy, p. 462. By S. Res. 311, 67th Cong., 2d sess., the Federal Trade Commission was directed to make a report on the foreign ownership of American oil companies. The report, Foreign Ownership in the Petroleum Industry, was made in 1923. The report emphasized the holdings of Royal Dutch-Shell.

[18] Letter from Walter C. Teagle to C. O. Swain, August 12, 1919. The statement was reputedly made in a pamphlet circulated to Shell stockholders. The American Petroleum Institute submitted the above statement to the State Department for its consideration.

were heightened by such evidence of British dominance as this statement of E. Mackay Edgar in Sperling's Journal in 1919:

> America is running through her stores of domestic oil and is forced to look abroad for future reserves. * * * The British position is impregnable. All the known oil fields, all the likely or probable oil fields outside of the United States itself, are in British hands or under British management or control, or financed by British capital. * * * To the tune of many million pounds a year, America before very long will have to purchase from British companies * * * a progressively increasing proportion of the oil she cannot do without and is no longer able to furnish from her own stores.[19]

Because of these factors, by the end of World War I nearly all of the important American oil companies were actively seeking foreign reserves. In this search, however, they were confronted in the Eastern Hemisphere with formidable obstacles, the most important ones being the national and colonial policies of Great Britain and the activities of British-Dutch oil companies which were, themselves, engaged in the search for foreign reserves. The British-Dutch companies were endeavoring to prevent the surrender of Empire reserves to the American "oil trust," while at the same time they were busily protecting a similar trust of their own. The national and colonial policies of other European countries were directed to similar objectives.

At least as early as 1902, Colonial Oil Co. of New Jersey, which prior to the dissolution was a subsidiary of the old Standard Oil Co. (New Jersey), applied to the Government of Burma for a license to prospect for oil. This application was refused. In the same year Anglo-American Oil Co., Ltd., a British subsidiary of Standard Oil Co. of New Jersey, was likewise refused a license to prospect for oil in India with the explanation that—

> It is not desired by the Government of India to introduce any of the American oil companies, or their subsidiary companies, into India. * * *[20]

Later, in 1905, applications of Standard Oil Co. (New York)—at this time also a subsidiary of the old Standard Oil Co. (New Jersey)—for permission to erect storage and refining facilities in India to be supplied by purchases of crude oil from Indian producers, were likewise denied.[21] Again, in 1917, a representative of Standard Oil Co. (New York) obtained an option to purchase or lease land and mineral rights from private owners in Assam; their effort to prospect for oil, however, was blocked by the Indian Government, acting in accordance with the "cardinal principle" that—

> The licensees shall be and remain British or state subjects or a company of British or state subjects under British or state control.[22]

As a result a single British company, the Burmah Oil Co. (partly owned by Anglo-Persian Oil Co. of which the British Government was part owner) was given a monopoly in the production of crude oil in British India. The British marketing interests in India also had become associated with the Dutch interests in the Far East, through the Royal Dutch-Shell merger of 1907, with the result that preference

[19] The Annals, May 1920, p. 133; reprinted from Sperling's Journal, September 1919. Mr. Edgar's remarks were reproduced in the United States Senate without a proper setting. Mr. Edgar was attempting to assuage British taxpayers who were objecting to a large increase in taxes to support Mesopotamia. His remarks, however, were not so interpreted in America. It was immediately after Mr. Edgar's statements were publicized in the United States that Senator Phelan introduced his Government corporation bill.

[20] Federal Trade Commission Report on Foreign Ownership in the Petroleum Industry (1923), p. 105, exhibit 15, letter of Standard Oil Co. (New York) February 24, 1922.

[21] Ibid., p. 106.

[22] Ibid., pp. 106-107.

both as to production and marketing was reserved to British and Dutch associated interests.[23]

The same principle appears to have been strictly applied prior to 1920 in certain other areas subject to British control, such as Canada and Australia, and in Crown lands and lands alienated by the Crown for agricultural purposes in Trinidad. In still other areas controlled by the British, similar restrictions were applied in varying degrees.[24]

Restrictive policies of the same general type were followed by the Netherlands, France, and other countries. In the Netherlands East Indies, where Standard Oil Co. (New Jersey) acquired certain prospecting rights under an oil mining law prior to 1920, these rights had been vested in Nederlandsche Koloniale Petroleum Maatschappij (Netherlands Colonial Petroleum Co.) a subsidiary of Standard Oil Co. (New Jersey). Standard of New Jersey stated in 1922 that expansion of its interests in the Far East was blocked—

> * * * through the refusal of the Government of the Dutch East Indies to grant prospecting licenses to the N. K. P. M. [Nederlandsche Koloniale Petroleum Mij.] or to grant mining concessions except in cases where the N. K. P. M. had a right to such concessions under the old mining law which provided that discovery of a mineral under a prospecting license gave the right to a concession.[25]

In Rumania and Russia, in which two other important foreign reserves had been developed prior to World War I, American and other foreign interests, including the British-Dutch "Shell" combination, acquired concessions prior to World War I. The Russian oil industry was nationalized and foreign interests were expropriated following the revolution in 1918. In Rumania, prior to 1918, portions of government oil lands were leased for private operations by both Rumanian and foreign capitalists. Most of this leasing occurred prior to 1909. In 1918, large land areas were expropriated from both Rumanian and foreign owners, and surface rights were resold to peasants, with the Government retaining the subsoil rights. This expropriation applied particularly to lands declared to be oil bearing, but not yet worked. Other portions of government lands, which were being worked, continued to be operated by both foreign and Rumanian private capital. In Poland, the only other country having important crude production in 1920, undeveloped lands were owned by the Government and exploration and exploitation were strictly supervised by the Government.[26]

In Greece, the Anglo-Persian Oil Co. obtained an exclusive concession of all petroleum rights in eastern and western Macedonia for an exploration period of 5 years, with an option for a 50-year exploration concession in some areas.[27] Thus British interests obtained exclusive rights to oil that might be discovered in Macedonia.

In Persia, the Anglo-Persian Oil Co., Ltd., obtained concessions through its subsidiary, North-Persian Oil Co., Ltd., under which it claimed control of a territory of 500,000 square miles containing the most promising oil-bearing lands of Persia. Persian production, developed by the British largely to support the oil-burning British

[23] Ibid., p. 39.

[24] Ibid., pp. 42-52. It is interesting to note that the merger of Royal Dutch Co., producing and refining in the Dutch East Indies, and Shell Transport & Trading Co., with crude oil production in Borneo and transportation and marketing facilities in the Far East and Europe, exemplifies a certain degree of elasticity in British policy. To enable Britain to escape to some degree from the previous domination of Standard Oil Co., the American companies were denied production and marketing privileges in India, while British and Dutch interests were permitted to participate in marketing their foreign products and their purchased oil both in the Far East and in Great Britain and continental Europe, with the Dutch owning 60 percent and the British 40 percent of the new merged company.

[25] Ibid., p. 125, exhibit 18, letter of Standard Oil Co. (New Jersey), August 4, 1922.

[26] Ibid., pp. 56-57.

[27] Ibid., pp. 57 and 96.

vessels during World War I, amounted to 16,673,000 barrels of crude in 1921.[28] The British Government participated in this development directly through its part ownership of Anglo-Persian Oil Co., Ltd. In southern Persia, also, Anglo-Persian Oil Co., Ltd., held a 60-year concession granted in 1901 to W. K. D'Arcy. Control of the northern Persian concessions, however, was rendered insecure following World War I by the claim of the Persian Government that the grant was invalid.[29] Iraq was not yet an important producer and the Bahrein Island, Saudi Arabia, Kuwait, and Qatar fields had not yet been discovered.[30]

Because of these national and colonial policies, therefore, attempts by American companies to obtain crude oil concessions in Asia had been largely unsuccessful, and, in 1920, the holdings of these companies were negligible in both Europe and Asia. In the foreign countries of the Western Hemisphere, however, similar political and private barriers did not exist, and in the early 1920's American companies became actively interested in oil concessions in Venezuela, Colombia, and Peru.

In 1920 there were no strong American oil interests in Latin America except in Mexico, which, however, was regarded as a declining source of supply.[31] The most important interests in Venezuela at this time were held by Royal Dutch-Shell, which previously had acquired control of the concessions held by subsidiaries of the General Asphalt Co.[32] It was on Shell's properties in the Maracaibo Basin that the first important Venezuelan oil field discoveries were made in December 1922 and in 1923.

While most of the oil interests in South America, except for those held by Shell, were small and undeveloped in 1920, a number of more important American companies became active in this area in the early 1920's. There were no political or private barriers to the entry of American oil companies in the Latin-American countries comparable to those in the Eastern Hemisphere. By 1932, however, two American companies—Standard Oil Co. (New Jersey) and Gulf Oil Corp.—had emerged as dominant forces in the South American oil industry, owning, together with Shell, practically all of South American production and most of the promising concession areas. These two companies built up their holdings by purchasing or merging with other Venezuelan interests, large and small, or by long-term leases of their properties.

Jersey Standard acquired its first South American interests in 1920, when its Canadian subsidiary, Imperial Oil Co., Ltd., organized the International Oil Co., Ltd., which took over an independent company of the same name, operating in Peru, and the Tropical Oil Co., operating in Colombia.[33] In 1921, Jersey Standard concluded a contract with the Maracaibo Oil Exploration Co., whereby Standard

[28] DeGolyer and MacNaughton, Twentieth Century Petroleum Statistics (1949), p. 24.
[29] Foreign Ownership in the Petroleum Industry (FTC, 1923) p. 62.
[30] Arabian American Oil Co., Summary of Middle East Oil Developments (1947).
[31] Except as otherwise noted, the information given in this and the succeeding paragraphs is taken from the annual editions, 1912–32, of Moody's Manual, Poor's Industrials and Moody's Industrials.
[32] Concessions held by the General Asphalt Co. date from as early as 1910. Control of these concessions passed to a subsidiary of Royal Dutch-Shell, Burlington Investment Co., Ltd., in the income of which General Asphalt owned a 24.8 percent interest. Burlington controlled the Caribbean Petroleum Co. (100 percent), Colon Development Co., Ltd. (75 percent), and Venezuelan Oil Concessions, Ltd. (extent of control not stated). Shell's Venezuelan interests have since been held by these companies and their successors. A minority interest (25 percent) in the Colon Development Co., Ltd., was held during the 1920's by an American company, Carib Syndicate, Ltd., and an affiliate. General Asphalt's interest in Shell's properties was reduced to a royalty basis in 1923.
[33] The predecessor to the International Oil Co. had been organized in 1914 to take over the properties of three British companies in Peru. The Tropical Oil Co. had been organized by American interests in 1914 to take up concessions in Colombia.

was to manage and develop a large part of its properties in the Maracaibo Basin for a two-thirds undivided interest in them.[34] In the following year, Jersey Standard entered into management contracts with British Controlled Oilfields, Ltd., and a subsidiary of that company, the latter companies to have a royalty interest in the oil produced. In 1928, Jersey Standard merged its interests with those of the Creole Syndicate, which owned important concessions acquired on its own account and through the purchase of four independent companies. Some of Creole's important concessions in the Maracaibo Basin were being developed under contract with the Gulf Oil Corp., and, despite the change in their ownership, Gulf has continued to manage these properties to this day.[35] Jersey Standard rounded out its Venezuelan holdings through the purchase in 1932 of the foreign properties of the Pan American Petroleum & Transport Co., a subsidiary of Standard Oil Co. (Indiana). These properties included the Lago Petroleum Co. and its affiliated and subsidiary companies, owning large concessions on the northeast shore of Lake Maracaibo, where the richest oil fields of Venezuela subsequently developed large installations and a refinery at Aruba in the Dutch West Indies, and ships and other transportation equipment.[36] Jersey Standard thus acquired the largest oil interest in Venezuela, except for itself, Gulf, and Shell.

Gulf Oil Corp. similarly built up its holdings largely by acquisitions of independent companies. In 1923, 1925, and 1929, for example, the South American Gulf Oil Co. bought concessions in the Maracaibo Basin from the Maracaibo Oil Exploration Co. for cash plus a royalty interest.[37] The Venezuela Gulf Oil Co. in 1924 purchased concessions from the Andes Petroleum Co. [38] and from the Venezuelan Petroleum Co., Ltd.,[39] the seller in both cases retaining royalty interests in the properties. In 1925, Gulf entered into the management contract with the Creole Syndicate mentioned above and in 1926 Gulf leased under option a large acreage from the Venezuelan Seaboard Oil Co., Inc.[40] All of these properties and interests acquired by Gulf were in the Maracaibo Basin.

In short, practically all of Venezuela's production and its most promising concessions came to be held by Royal Dutch-Shell, the first important oil interest in Venezuela, and by two American companies, Jersey Standard and Gulf, which had built up their holdings by purchase, merger, and lease of the outstanding independent companies.

In the Eastern Hemisphere, the major oil companies, American and foreign, turned their interests to the Middle East after 1920 in the

[34] Maracaibo Oil Exploration Co. was organized in Delaware in 1919 to take over and develop the properties of four predecessor companies.

[35] The Creole Syndicate was organized in Delaware in 1920 and soon thereafter acquired a number of Lake Maracaibo properties. These properties were taken over by Gulf under management contracts in 1925. Creole purchased four independent companies in 1926–28, whose principal assets were Venezuelan concessions.

[36] Lago Petroleum Co. was organized by American and British interests in 1923 and immediately acquired large concessions in Venezuela. In 1924, Lago and the British Mexican Petroleum Co., Ltd., an affiliate of Pan American, jointly organized the Lago Oil and Transport Co. which acquired property at Aruba built terminal facilities there, and acquired some tankships. The same British interests that participated in Lago appear to have been interested in British Mexican. In March 1927, Lago purchased a "substantial block of stock of Creole Syndicate." Standard of Indiana acquired control of Pan American in 1925 and Pan American acquired control of Lago and its affiliates in 1926.

[37] These properties were apparently transferred later to some other Gulf subsidiary, probably Venezuela Gulf Oil Co., for when South American Gulf was sold in 1936 to the Texas Co. and Socony-Vacuum, it held only Colombian assets, these being chiefly a 75-percent interest, acquired in 1926 from the Cities Service Co., in the Barco Concession in Colombia.

[38] The assets of the Andes Petroleum Co. were jointly held by Andes and by the Atlantic Gulf Refining Co., a subsidiary of Atlantic Refining Co.

[39] Control of the Venezuelan Petroleum Co. was purchased by Sinclair Consolidated Oil Corp. in 1930. The date of Gulf's purchase was not clearly stated in Moody's Manual and may have been in 1923.

[40] This company was a subsidiary of Mexican Seabord Oil Co. It is not made clear in the financial manuals whether or not the "option," presumably to purchase, was exercised. In 1930 or 1931, Venezuelan Seaboard and Creole, a subsidiary of Jersey Standard, "pooled" their concessions in the State of Monagas, Venezuela.

effort to satisfy their increasing needs for foreign reserves. This area not only gave promise of a treasure of oil, but it was also one where political and private barriers did not appear to be insuperable. Concessions in this area were granted after 1920 for large areas, including in a number of cases the entire area of a country, the concession holder generally being a subsidiary company owned by several of the major international oil companies. In this way all seven of the major international oil companies discussed in chapter II became interested in Middle East oil.

Summary: The techniques of control.—Prior to 1920 American companies either had been indifferent to foreign reserves or they had been largely frustrated in their efforts to acquire reserves in the Eastern Hemisphere, owing to restrictive national and colonial policies of foreign governments and of private oil interests. After 1920, however, they became actively interested in foreign reserves, spurred by the dual fears of a prospective shortage of American oil and of a British-Dutch monopoly of foreign reserves. This increasing interest was also stimulated by the rising costs of American oil and the current and prospective discoveries of large foreign reserves which would afford to their owners a ready supply of cheap oil, advantageously located to important consuming markets.

This growing interest was transformed into successful effort by the American oil companies in acquiring substantial oil reserves in South America, principally in Venezuela, and in the Middle East. The following chapters of part II describe the process by which these oil reserves were brought under the control of the seven international oil companies.

This control over foreign reserves has been achieved through the use of two techniques, joint ownership and long-term contracts for the sale of crude oil. In the Middle East, the interests of the seven international oil companies have been woven together by joint ownerships of subsidiary companies, each holding interests in one or more of these joint enterprises. This interlacing of control is revealed through the history of the political and private diplomatic negotiations preceding the organization of the jointly owned subsidiary companies and by an analysis of the management and operational policies of these subsidiaries after their organization. The interests in the Middle East of five of the seven international oil companies have been still more closely interwoven by the execution among them of long-term contracts for the sale of crude oil. The long period of the contracts, the great quantities of oil involved, the unusual nature of the pricing methods and the conditions of sale, and the inclusion of provisions restricting the marketing of the oil suggest that these contracts extend far beyond the ordinary business transaction.

In Venezuela, the three international oil companies owning the bulk of that nation's oil reserves and production were closely bound together through long-term contracts for the sale of crude oil. Closely allied to these agreements, which in effect bound the three companies together in a partnership, were other agreements designed to impose restrictive controls on the production of two of these companies.

As a guide to the discussion in chapters IV, V, and VI, there are presented below the names and ownership of the principal corporate bodies operating in the Middle East.[41]

[41] This information was compiled from Arabian American Oil Co., Summary of Middle East Oil Developments (1948). So far as is known, there have been no significant changes in this information. The British Government's share of Anglo-Iranian is sometimes given as a slightly lesser proportion.

I. The following three companies of British nationality control the entire oil reserves of Iraq:

1. Iraq Petroleum Co., Ltd. (formerly Turkish Petroleum Co.), 75-year concession in provinces of Bagdad and Mosul east of the Tigris River granted in 1925 as a revival and revision of concessions granted by Turkey before World War I.

2. Mosul Petroleum Co. (formerly British Oil Development Co.), 75-year concession covering the area west of the Tigris River and north of latitude 33°, originally granted to British Oil Development Co. in 1933.

3. Basrah Petroleum Co., Ltd., 75-year concession covering the province of Basrah, granted in 1938.

The ownership of these three companies is divided as follows:

	Percent
Royal Dutch-Shell Co. (British and Dutch)	23.75
Anglo Iranian Oil Co., Ltd. (British)	23.75
Compagnie Française Des Petroles (French)	23.75
Near East Development Co. (American) representing:	
Standard Oil Co. (New Jersey), 11.875 percent; Socony-Vacuum Oil Co., 11.875 percent	23.75
C. S. Gulbenkian (Syrian individual of British citizenship)	5.00
Total	100.00

II. Anglo-Iranian Oil Co., Ltd. (originally Anglo-Persian Oil Co., Ltd.), original concession to William D'Arcy in 1901 revised to a 60-year concession in 1933 covering 100,000 square miles in Iran. The company is owned by—

	Percent
British Government	56
Burmah Oil Co. (British-Royal Dutch-Shell affiliate)	22
Individuals	22
Total	100

III. Kuwait Oil Co. Ltd., 75-year concession granted in 1934, covering all of Sheikhdom of Kuwait. Company is owned by—

	Percent
Anglo-Iranian Oil Co., Ltd. (British)	50
Gulf Exploration Co. (American-Gulf Oil Co.)	50
Total	100

IV. Bahrein Petroleum Co., 55-year concession granted in 1940, covering all of Bahrein Islands and territorial waters. The company is owned by—

	Percent
Standard Oil Co. of California	50
The Texas Co	50
Total	100

V. Arabian American Oil Co., originally a 66-year concession granted to Standard Oil Co. of California in 1933. This concession was augmented in area in 1939 to cover a total of 440,000 square miles in Saudi Arabia and the entire concession was assigned to Arabian American Oil Co., which is jointly owned by—

	Percent
Standard Oil Co. of California	30
The Texas Co	30
Standard Oil Co., New Jersey	30
Socony-Vacuum Oil Co., Inc	10
Total	100

CHAPTER IV

JOINT CONTROL THROUGH COMMON OWNERSHIP—THE IRAQ PATROLEUM CO., LTD.

The Iraq Petroleum Co., Ltd., was the first joint venture in which important American and foreign oil companies were united in one operation. In the words of one of its founders, IPC "is a unique company born of prolonged and arduous diplomatic and economic negotiations." [1] The history of IPC, which is probably more tangled and dramatic than that of any other oil company, reveals that restrictive influences were at work from its inception. IPC was not organized and operated as an independent corporate entity; rather its policies and management were determined by and made to serve the mutual interests of the major international oil companies which jointly owned the majority of its shares.

HISTORY AND EARLY DEVELOPMENT

The history of IPC dates back to the last decade of the nineteenth century when C. S. Gulbenkian, an Armenian, made a comprehensive report on the oil possibilities of Mesopotamia, which attracted the attention of the Turkish Sultan's Minister of the Liste Civile [2] and the Minister of Mines. Gulbenkian's report prompted the Turkish Sultan, Abdul Hamid, in 1904 to transfer the ownership of immense tracts of land in Mesopotamia from the Ministry of Mines to the Liste Civile. This, in fact, was a transfer from the government to his private account.

Interest in oil concessions in the Near East was growing, and competition between British and German interests for oil and railroad concessions was especially keen.[3] Around 1890, the Germans, through the Deutsche Bank, secured a concession in Mesopotamia for the Bagdad Railway, which included mining rights extending 20 kilometers on both sides of the projected railway.[4] The Germans were anxious to enlarge the claims of the Bagdad Railway but were hampered by the shift in ownership from the Turkish Government to the Liste Civile. Whereas their concession had been granted by the former, it was the latter which now owned the lands. Not only were the Germans unable to obtain concurrent mining rights in the same region; it was even deemed inadvisable to press the Turkish Government for concessions on lands held by the Liste. The German interests did, however, obtain a letter from the Turkish Government which promised preferential treatment regarding mining rights.[5]

[1] From Memoirs of Calouste Sarkis Gulbenkian With Particular Reference to the Origins and Foundation of the Iraq Petroleum Co., Ltd., Lisbon, September 16, 1941.

[2] "Liste Civile" means the Ministry of the Privy Purse, sometimes known as the Private Purse of the Sultan.

[3] An American, retired Rear Adm. Colby M. Chester, was also negotiating for oil concessions in the Near East, but his activities had little direct relation to the founding of the Iraq Petroleum Co., Ltd.

[4] Gulbenkian Memoirs, op. cit.

[5] Ibid.

At about the same time, British interests were also bargaining with the Turks for an oil concession. In 1901, William K. D'Arcy[6] obtained a 60-year oil concession from the Shah of Persia covering 500,000 square miles, or five-sixths of the Persian Empire (now Iran).[7] Mr. D'Arcy, anxious to extend his concession into Mesopotamia, sent representatives to negotiate with the Minister of the Turkish Liste Civile in 1901 and again in 1903. But the nearest thing to a concession which he obtained was a letter from the Grand Vizier promising that the Sultan would confirm the arrangement for oil rights in Mesopotamia.[8]

In 1904, after a visit to Constantinople by the Kaiser, the German-owned Anatolian Railway Co. obtained a concession from the Sultan's Liste Civile to explore for oil within a radius of 20 kilometers on both sides of the proposed right-of-way in the Vilayets[9] of Mosul and Bagdad. The concession contract provided that if certain development work were not performed within a stipulated period, the concession would become null and void and that the Liste Civile was to reimburse the concessionaires for all expenditures.[10]

Mr. D'Arcy again entered the bargaining in 1904. Although he was again unable to obtain confirmation of the Sultan's promise, as a result of his efforts the Sultan informed the Germans that their rights under their concession had expired because of nonperformance. The Germans filed a claim with the Liste Civile for £20,000, covering expenditures made for geological work performed, but the claim was never paid and the Germans, therefore, took the position that the concession was never invalidated.[11]

From 1904 to 1912 many attempts were made by both the Germans and the British to obtain confirmation of their claims to Mesopotamia oil, with only the negative result that each was successful in blocking the other's efforts. In 1908, D'Arcy incorporated as D'Arcy Exploration Co.[12] and transferred all his oil claims in Mesopotamia and Persia to Anglo-Persian Oil Co., Ltd. In the spring of 1909, he was about to close a deal with the Turks when the Young Turk Revolution swept Sultan Abdul Hamid out of power. The Young Turk Government was pro-British; and in 1910, a new institution, the National Bank of Turkey, was founded to support British enterprise in Turkey. All the capital was held by British citizens, and C. S. Gulbenkian was nominated a director and a member of its executive committee. Mr. Gulbenkian apparently believed that a satisfactory solution to the Mesopotamia oil claims could be attained only by cooperation with the German interests. Accordingly, overtures were made and an agreement was reached between the National Bank of Turkey and the Deutsche Bank, which controlled the Anatolian and Bagdad railways, to form a British limited-liability company in which the Deutsche Bank would hold a 25-percent interest. Thus there was formed on January 31, 1911, African and Eastern Concessions Limited, which on October 23, 1912, became the Turkish Petroleum Co. (with a capital of £80,000); and in April 1929, became the Iraq Petroleum

[6] D'Arcy, who had been a speculator in mining ventures in Australia and elsewhere, is chiefly known as a pioneer oil prospector and diplomat in the Middle East.

[7] This is the concession now held in Iran by the Anglo-Iranian Oil Co., Ltd.

[8] W. C. Teagle, Confidential Memorandum of Negotiations with the Turkish Petroleum Co., Ltd.,

[9] Turkish provinces.

[10] History of the IPC and Mr. Gulbenkian's Part in Its Foundation, also letter from H. Riedemann to W. C. Teagle, October 10, 1920.

[11] Teagle, op. cit.

[12] Davenport and Cooke, op. cit., p. 24.

Co., Ltd.[13] Ownership of the shares of the Turkish Petroleum Co. (hereafter called TPC) was distributed as follows:

	Percent
Deutsche Bank	25
National Bank of Turkey (15 percent was held for Mr. Gulbenkian)	50
Anglo-Saxon Petroleum Co., Ltd.[13a] (Subsidiary of Royal Dutch-Shell)	25

The most important feature of the new corporation was an agreement by the parties not to compete with the company in obtaining concessions and not to hold any concessions independently of the company.[14] The Deutsche Bank, in return for a 25-percent interest in the Turkish Petroleum Co., conceded to the company the claims held by the Anatolian and Bagdad railways.

Although one group of British interests owned part of the Turkish Petroleum Co. through the National Bank of Turkey, the D'Arcy group found itself excluded. It pressed vigorously for an interest in the company. The D'Arcy interests themselves were taken over in 1909 by a new firm, Anglo-Persian Oil Co., the name of which was later changed to Anglo-Iranian Oil Co.

During the period 1904–14, when the British and Germans were competing for oil concessions in the Middle East, the British Government was considering the possibility of converting the British Navy from coal to oil. On March 3, 1913, the British Royal Commission which had been appointed to study the problem reported that the British Navy should fuel with oil, which, of course, had to come from abroad, instead of coal, which the British Isles produced in abundance.[15] Winston Churchill, then First Lord of the Admiralty, announced the Admiralty's oil policy in a speech before the House of Commons on July 17, 1913, in the following words:

> Our ultimate policy is that the Admiralty should become the independent owner and producer of its own supplies of liquid fuel. * * * We must become the owners, or at any rate the controllers at the source, of at least a proportion of the supply of natural oil which we require.[16]

The policy led to the purchase of a controlling stock interest in Anglo-Persian Oil Co.[17] by the British Government in May 1914. The British Government also obtained the power to appoint two directors of the company. Although these directors were supposed to have no part in the ordinary commercial management of the business, they had the power to veto any proposal made by the other directors.[18]

Despite these various maneuvers, neither D'Arcy's group, now held by Anglo-Persian, nor the Turkish Petroleum Co. had yet been able to obtain an actual concession agreement for Middle East oil. With the British Government actively engaged in pushing Anglo-Persian's interest, the owners of the rival Turkish Petroleum Co. felt that steps were necessary to remove the opposition of Anglo-

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13 Minutes of Meeting of Directors, April 25, 1929.

13a Anglo-Saxon was and is owned by Royal Dutch-Shell. Mr. Gulbenkian had been in partnership with Royal Dutch-Shell in many business ventures, and when Turkish Petroleum Co. was founded, he offered Royal Dutch 20,000 shares, or a 25-percent interest in the company. Gulbenkian's interest in African and Eastern Concessions, Ltd., had been 40 percent.

14 History of IPC, op. cit.

15 Davenport and Cooke, op. cit., pp. 16–21. Also reprinted in American Petroleum Interests in Foreign Countries.

16 Statement to House of Commons July 17, 1913.

17 Anglo-Persian, which is now Anglo-Iranian Oil Co., Ltd., is owned 56 percent by the British Government, 22 percent by Burmah Oil, and 22 percent by the British public.

18 Davenport and Cooke, op. cit., p. 23.

Persian. Accordingly, a conference was held in 1914 at the British Foreign Office, and the Foreign Office agreement of March 19, 1914, was adopted. Parties to the agreement were representatives of the German and British Governments, the National Bank of Turkey, Royal Dutch-Shell through the Anglo-Saxon Petroleum Co., Ltd., the D'Arcy group, and the Deutsche Bank. This agreement provided for a fusion of interest in Turkish Petroleum Co. concessions. Specifically it was agreed that the D'Arcy group (acting for Anglo-Persian) should obtain a 50-percent stock interest in Turkish Petroleum Co., while the Deutsche Bank and Anglo-Saxon Petroleum Co. were each to hold a 25-percent stock interest. A 5-percent beneficiary interest for Mr. C. S. Gulbenkian was to be contributed equally by the D'Arcy and Anglo-Saxon groups out of their respective holdings, and, in the event of Gulbenkian's death, the D'Arcy group and Anglo-Saxon were to have the option of purchasing his interest in their names. Aside from admitting the D'Arcy group into Turkish Petroleum Co., the Foreign Office agreement also provided that—

> the three groups participating in the Turkish Petroleum Co. shall give undertakings on their own behalf and on behalf of the companies associated with them not to be interested directly or indirectly in the production or manufacture of crude oil in the Ottoman Empire in Europe and Asia, except in that part which is under the administration of the Egyptian Government or the Sheikh of Koweit or in the transferred territories on the Turco-Persian frontier,[19] otherwise than through the Turkish Petroleum Co.[20]

This provision and Gulbenkian's 5-percent share became important factors in subsequent negotiations.

Following the adoption of the Foreign Office agreement, the Turkish Petroleum Co., prompted by the British and German Ambassadors,[21] continued to press for a concession agreement with the Turkish Government. On May 18, 1914, the German and British Ambassadors handed to the Turkish Government the draft of a convention covering the oil rights in Mosul and Bagdad. On June 28, 1914, the Grand Vizier agreed to lease the rights to the Turkish Petroleum Co., stating:

> The Minister of Finance, which has taken over from the civil list matters concerning petroleum deposits already discovered or to be discovered in the vilayets of Mosul and Bagdad, agrees to lease them to the Turkish Petroleum Co., and reserves the right later on to fix its own share as well as the general terms of the agreement.[22]

This was a promise for a concession, but the war interrupted negotiations before an agreement was reached, and the operations of Turkish Petroleum Co. remained suspended until 1918. The statement by the Grand Vizier, however, was one on which the Turkish Petroleum Co. relied heavily for its claims to Mesopotamian oil after World War I.

All negotiations for an oil concession in the Middle East ceased with the outbreak of war in 1914. The stock interest of the Deutsche Bank in Turkish Petroleum Co. was taken over by the British Alien Property Custodian and held throughout the war. After the armistice of 1918, however, negotiations between the English and French were undertaken, resulting in the signing of the San Remo agreement on April 24, 1920.[23] This agreement awarded the Deutsche Bank's

[19] These were small areas transferred by Iran to Iraq as a result of an early agreement between Persia (Iran) and the Turkish Empire made in 1913. The oil concessions in this area are now held by Anglo-Iranian Oil Co.

[20] Sec. 10, Foreign Office agreement, March 19, 1914.

[21] History of the IPC and Mr. Gulbenkian's Part in Its Foundation, April 1944.

[22] History of the IPC, op. cit., p. 9.

[23] The San Remo agreement was included as exhibit 14, p. 103, in a Report on Foreign Ownership in the Petroleum Industry, op. cit.

25-percent share in Turkish Petroleum Co. to the French Government. In return, the French consented to the construction of pipelines and the transportation of oil through French spheres of influence from Mesopotamia to the Mediterranean. Another provision of the San Remo agreement provided for the granting to the native Government of Mesopotamia of a 20-percent interest in any private petroleum company that was set up to exploit the oil lands of that country. The French and British, under the agreement, were to support their respective nationals in any common negotiations for oil concessions in Rumania or Russia.

AMERICAN-BRITISH DISPUTE OVER MESOPOTAMIA AND THE "OPEN DOOR"

The alleged British oil monopoly in British mandated territories and the signing of the San Remo agreement led to a heated and prolonged diplomatic dispute between American and British Governments over the oil resources of the Middle East. The American Government, under Secretary of State Colby and later under Secretary of State Hughes, waged a determined diplomatic battle with the British regarding the rights of American oil companies to participate in the development of Middle East oil resources.[24]

Before World War I, Mesopotamia (now Iraq), had been a part of the old Ottoman Empire under Turkish control, but, at the close of the war, Mesopotamia became a mandated area under British control.[25] In 1919, when the British refused to permit American oil companies to send exploration parties into Mesopotamia, a diplomatic dispute arose which resulted in a long series of diplomatic notes and protests being exchanged between the American and British Governments. Between the two Governments, the dispute was over the principles which should apply in mandated regions (thus including the San Remo agreement). Underlying this issue, however, was a struggle between the major oil companies of the United States and Great Britain, actively supported by their respective Governments, over the oil resources of the Middle East.

The American position in the dispute was essentially the "open door" policy, the important provisions of which were (1) that the nationals of all nations be subject, in all mandated territories, to equal treatment in law, (2) that no economic concessions in any mandated region be so large as to be exclusive, and (3) that no monopolistic concession relating to any commodity be granted. The United States Government maintained that the war had been won by the Allied and Associated Powers fighting together, and that, consequently, any benefit, whether in oil interests or otherwise, should be available to the nationals of all the Allied Powers, and should not be seized by those of any one particular power. Moreover, the United States asserted that the San Remo agreement discriminated against the rights of American nationals, that no oil rights in Iraq were vested in the Turkish Petroleum Co., and that no valid concessions could come

[24] For a more complete and detailed explanation of the British-American dispute over the oil resources of Mesopotamia and the Middle East, cf. Herbert Feis, Petroleum and American Foreign Policy, Stanford, University, March 1944; Diplomatic Protection of American Petroleum Interests in Mesopotamia, Netherlands East Indies, and Mexico, S. Doc. No. 43, 79th Cong., 1st sess.; and Davenport and Cooke, op. cit.

[25] It will be recalled that under the peace treaty of August 10, 1920, signed between Turkey and the principal Allied Powers, Turkey renounced her rights and titles to certain territories she formerly held in the Ottoman Empire. The renounced territories included Mesopotamia, Palestine, Syria, and Lebanon. Although the peace treaty was not signed until August 1920, the allied conference at San Remo in April 1920 allocated Mesopotamia and Palestine to Great Britain, and Syria and Lebanon to France. These allocated territories thus became mandates of Britain and France, respectively.

into existence except through the government of the people of the territory. The British point of view was that British nationals had "acquired rights," that these rights must be respected, and that, although the United States had been an Allied Power, this fact gave its nationals no right to trespass upon "acquired rights." The term "acquired rights" referred to the rights held by the Turkish Petroleum Co. and the rights promised to that company by the Ottoman Grand Vizier, as evidenced by his letter of June 28, 1914, to the British and German Ambassadors.[26] The controversy between the British and American Governments continued until the partners of the Turkish Petroleum Co. consented to discuss with representatives of the American oil industry a basis for American patricipation in the Turkish Petroleum Co. The resultant negotiation revolved around the State Department's "open door" policy. It will be discussed in detail in a subsequent section.

Early efforts of American oil companies to obtain a foothold in Mesopotamia.—During the dispute between the British and American Governments, the American oil companies, working through official channels, were continuing their own efforts to gain a foothold in the Middle East. In the summer of 1919, Standard Oil Co. (New Jersey), indicated an interest in the oil fields of Mesopotamia, and the problem was discussed with the United States Government. Standard was advised that the efforts of any single company to obtain concessions in Mesopotamia would not be supported, but that the Government would act in behalf of the entire American petroleum industry. Later in 1919, the American Petroleum Institute adopted a resolution in which it expressed the fear that American oil companies might be excluded from participation in Mesopotamian oil and asked that the State Department take appropriate action. In November 1919, Walter C. Teagle, president of Standard Oil Co. (New Jersey), working through the United States Bureau of Mines, asked permission to send a geological survey party into Mesopotamia. He was advised, however, that the State Department had already taken up the Mesopotamian question with the British Government and had been informed that no oil reconnaissance parties would be permitted until the status of Mesopotamia was finally decided.

In November 1921, a group of seven American companies notified the State Department that they were prepared to send a party of geologists and engineers to Mesopotamia for a reconnaissance survey.[27] After petitioning the Secretary of State for permission to make the indicated survey, they were advised that "as soon as this Department learns that permission for prospecting in Mesopotamia is being or may be granted by the authorities in that territory, you will be promptly informed." [28]

While the American oil companies directed most of their efforts through official channels, they also investigated the possibility of secretly purchasing the claims to concession rights in Mesopotamia held by the Deutsche Bank. As previously noted, these claims had been granted to the Bagdad and Anatolian railways, and were turned over to the Turkish Petroleum Co. in 1912.[29] After a full investi-

[26] See p. 50.
[27] Companies which first indicated an interest were: Mexican Petroleum Co., the Texas Co., the Gulf Refining Co., the Atlantic Refining Co., Sinclair Consolidated Oil Corp., Standard Oil Co. (New York), Standard Oil Co. (New Jersey).
[28] History of Negotiations Leading to Participation of American Companies in IPC.
[29] See p. 49.

gation, however, it was decided that, because of the many political complexities involved, a better procedure would be to continue the efforts to obtain participation in Turkish Petroleum Co.

It should be remembered that during the period of these negotiations, the United States was the most important supplier of oil in the world. The American oil industry produced in 1921 about 65 percent of the world's oil supplies, and purchased about 17 percent of the remainder (mostly from Mexico). After satisfying all American needs, the industry exported about 58 percent of total foreign requirements.[30] Anglo-American Oil Co., a former subsidiary of Standard Oil Co. (New Jersey), controlled over 50 percent of the total business of the United Kingdom.[31] Thus, the American oil companies were in a strong bargaining position. It is not known if they actually used their bargaining strength to the extent of threatening to withdraw from the export market, but the possibility was discussed by officials of Standard Oil Co. (New Jersey).[32]

Negotiations with the Turkish Petroleum Co. (TPC), 1922–28.—A definite improvement in the tense relations between the American and British-Dutch oil companies and their respective governments occurred in June 1922 when Sir Charles Greenway, chairman of the Anglo-Persian Oil Co., cabled A. C. Bedford of the Standard Oil Co. (New Jersey), suggesting that a representative be sent to meet with the Turkish Petroleum Co. at the earliest possible moment.[33] The matter was discussed with Secretary of State Hughes, and on June 26, 1922, Mr. Bedford informed Sir Charles Greenway that he had conferred with the State Department and obtained its consent to discuss a basis for American participation in the Turkish Petroleum Co., provided (1) that the principle of the "open door" in mandated territories be maintained, (2) that the State Department not withdraw its views respecting the validity of the Turkish Petroleum Co. claims in Mesopotamia, and (3) that any arrangement of practical questions involved should be on a tentative basis and subject to acceptance by the State Department.[34] Sir Charles replied that any discussion would be without prejudice to existing conditions or to the rights on either side and to the approval of their respective governments.[35]

The seven American oil companies that had been interested in Mesopotamian oil selected W. C. Teagle and W. D. Asche, president and vice president, respectively, of the Standard Oil Co. (New Jersey), to represent the American companies in the negotiations with TPC. Negotiations began in July 1922 and continued for 6 years, until 1928, when the American group's share interest in TPC was finally settled.

[30] Data published in Davenport & Cooke, op. cit., p. 69, and were prepared by the Department of Commerce.

[31] Letter from F. E. Powell to F. D. Asche, May 14, 1920.

Anglo-American Oil Co., Ltd. was a wholly owned subsidiary of Standard Oil Co. (New Jersey) until the dissolution decree of May 1911. It was reacquired by Standard in 1930. See footnote 1, p. 552.

[32] Ibid.

[33] The cable from Sir Charles Greenway to Mr. Bedford read as follows:

"As all mandates are to be considered by special session of Council of League of Nations not later than July 15, I shall be unable to induce our Government to delay reply to American note much longer. Therefore, if you wish to follow up idea discussed with me, it is of the utmost importance that no time be lost and you should send representative to meet Turkish company earliest moment."

Apparently, Sir Charles Greenway wanted to open negotiations with the American companies prior to the date when the British Government would have to reply to the last American note concerning the Mesopotamian oil problem.

[34] Cable from A. C. Bedford, New York, to Sir Charles Greenway, London, June 26, 1922.

[35] Cable from Greenway to A. C. Bedford, June 27, 1922.

In order to enable the American companies to come to a group decision and to keep up with the negotiations, frequent meetings of the group were held in this country throughout the period 1922–28. Early in the negotiations, the Texas Co. indicated that it no longer desired to obtain an interest in TPC. Later, Sinclair also dropped out. When negotiations were completed on July 31, 1928, only five American companies participated in the Near East Development Co., the corporation established to hold the American group's interest in TPC. Standard Oil Co. (New Jersey) and Standard Oil Co. (New York) each received a 25-percent interest, while each of the three remaining companies was allotted a 16⅔ percent share.[36]

The negotiations between the TPC and the American group expressed not only private but also governmental interests. It will be recalled that the British Government owned a controlling stock interest in the Anglo-Persian Oil Co. whose subsidiary, D'Arcy Exploration Co., held a 50-percent interest in TPC. Royal Dutch-Shell, whose 25-percent interest in TPC was held by Anglo-Saxon, was owned by both English and Dutch capital, and both Governments were interested in its affairs. The French Government formed a quasi-governmental corporation, Compagnie Francaise des Petroles (CFP), to hold its 25-percent share interest in TPC.[37] The American group had the official support of the United States Government. The only private owner who participated in the negotiations without governmental support was Mr. Gulbenkian, and he held a claim to only a 5-percent beneficial share interest in TPC. Throughout the prolonged negotiations, the United States, British, and French Governments were kept continuously informed of developments, and the interested companies were never at a loss for official sanction or advice on any particular point at issue.

No attempt will be made in this report to discuss or analyze the political considerations that may have influenced the decisions of the respective interested groups. Moreover, it is not necessary to discuss many aspects of the struggle for commercial as distinct from political advantage. Attention will be focused upon the central issues upon which the groups had to agree before the American group could be

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[36] The 5 companies were: Standard Oil Co. (New Jersey), Standard Oil Co. (New York), Gulf Refining Co., Atlantic Refining Co., and Mexican Petroleum Co. The Pan American Petroleum & Transport Co. replaced the Mexican Petroleum Co. in February 1927 when Sinclair dropped out.

In 1931, Standard Oil Co. (New York) merged with Vacuum Oil Co. Its name was changed to Socony-Vacuum Corp. and, in 1934, to Socony-Vacuum Oil Co., Inc. Around 1930 Socony-Vacuum and Standard Oil Co. (New Jersey) purchased the share interests in NEDC held by Pan-American and Atlantic Refining. Thus, at the end of 1931, there were 3 American oil companies holding shares in IPC through NEDC in the following proportions:

	Percent of IPC stock	*Percent of NEDC stock*
Standard Oil Co. (New Jersey)	9.8958	41.6667
Socony-Vacuum Corp	9.8958	41.6667
Gulf Oil Corp	3.9584	16.6666
Total	23.75	100

In 1934, Gulf sold its ⅙ interest to Standard and Socony-Vacuum, leaving the entire American interest in Iraq to 2 companies, as compared to 7 that were originally interested.

[37] Compagnie Francaise des Petroles was organized in 1923 by the leading French banks and by the marketing and refining subsidiaries of the international oil companies. Early in 1924, CFP concluded an agreement with the French Government whereby CFP received the sole rights to the French share of Iraq oil. Subsequently, in 1929, the French Government took a quarter-share interest in CFP which in 1931 was increased to 35 percent with a 40-percent control of the company. See the Petroleum Times, May 3, 1930, p. 802; January 17, 1931, p. 97; and April 4, 1931, p. 501.

It should be noted that the British and American groups interested in TPC owned indirectly a share interest in TPC by the fact that their French subsidiaries held shares in CFP. In 1927, Standard Oil Co. (New Jersey) had 4 French subsidiaries that held a 9-percent interest in CFP which gave Standard an indirect interest in TPC of a little more than 2 percent. Source, interoffice memoranda from Guy Wellman to W. C. Teagle, March 25 and 28, 1927.

admitted as a shareholder in TPC. The major points which the groups interested in TPC had to settle and which consumed most of the time of the negotiators were: [38]

The "open door" plan;
The self-denying clause;
The working agreement;
The controversy with Gulbenkian;
The Anglo-Persian Oil Co.'s overriding royalty; and
The American group's share interest in TPC.

The "open door plan" is proposed.—When discussions with the TPC representatives began in 1922, the American group proposed the adoption of the "open door" policy. The policy had been enunciated by the State Department in the diplomatic dispute with the British, and its adoption was made a sine qua non of American participation in TPC. In their first attempt to reach a workable basis, the American group proposed a plan for effecting the "open door" patterned along the lines followed by the United States Department of the Interior in the sale of Osage Indian lands. Under the plan, TPC, within 2 years from the date of confirmation of a concession by the Iraq Government, would have selected for its own exploitation a total area not to exceed 12 blocks, the area of each block not to exceed 16 square miles. The balance of the concession, totaling some 150,000 square miles, would then have been open for subleasing by any responsible individual or corporation that might be interested in the development of oil production in Iraq. TPC would not have been a bidder on any of the subleases, but the owners of TPC, acting on their own initiative, would have been free to obtain subleases, as would any other American oil company that might have been interested in Mesopotamian oil.[39] Thus, as originally proposed, the "open door" would have been open to any and all companies interested in oil concessions in this area.

The "open door" is partially closed.—Early in their discussions with the American group, the partners in TPC admitted that it would be impossible to undertake any development work in Iraq until TPC's questionable claims to a concession were confirmed by the Iraq Government. The American group from the beginning had maintained that TPC claims were invalid. In 1923, TPC began active negotiations with the Iraq Government for a concession agreement which would validate TPC's claim. Throughout these discussions, the American group insisted that the convention with the Iraq Government include provisions giving effect to the "open door" policy. The convention, concluded on March 14, 1925, included a number of provisions relating to the "open door" plan which, however, differed considerably from the original American proposals.

Under article 5 of the agreement of March 14, 1925, TPC was to select, within 32 months from the date of the agreement, 24 rectangular plots of 8 square miles each, total area of 192 square miles, for the

[38] Although it was not a major issue in the negotiations, the groups discussed at some length the question of whether TPC should be permitted to erect a refinery at seaboard.

The British group (Shell and Anglo-Persian), especially Royal Dutch-Shell, wanted the TPC to have the privilege of erecting a refinery outside of Iraq for the purpose of refining such oil as the partners in TPC refused to take. The American group, and particularly Standard Oil Co. (New York), was opposed to TPC operating a refinery outside Iraq. In this connection, it should be noted that in the early 1920's, the Standard interests were the world's principal suppliers of refined products, and it was not to their interest to permit the construction of a potentially competitive refinery. In the final compromise, it was provided that TPC could erect a refinery for the purposes indicated, but only if all the major groups gave their consent in writing. Thus, the American group, in effect, won.

[39] Memorandum of negotiations with Turkish Petroleum Co., Ltd.

company's exclusive exploitation. With respect to the remaining part of the concession, described as "outside areas," article 6 of the agreement provided that the Iraq Government, within 4 years from the date of the signing of the concession agreement and annually thereafter, was to select not less than 24 rectangular plots of 8 square miles each and offer them for competition under sealed bid to any responsible corporation, firm, or individual that desired to lease them.[40]

The "open door" provisions in the Iraq convention made major modifications in the "open door" plan as originally proposed. First, the Government instead of the company would offer the areas. Second, the competition for outside areas was to be through sealed tender rather than through public or open bidding. Third, the company (TPC) reserved the right, as the Government's agent, to advertise the plots, to open the tenders, and to make decisions about them in the presence of an authorized representative of the Government. Fourth, the prohibition against bidding by the company on outside offerings was omitted. These changes went a long way toward closing the "open door." The fact that the plan for submitting bids was changed from public auction with oral bids to sealed bids, with TPC acting substantially as awarding authority, gave the company effective veto power over all bids. Furthermore, since TPC could also offer bids, any prospective lessee could be outbid at no cost to TPC, since the proceeds from the sale would be returned to the company (TPC).

The American group was opposed to these changes in the "open door" plan. In commenting upon the change from auction to sealed bids, one American oil-company representative stated that he "personally deplored this change because it undoubtedly opens the door to chicanery and fraud, assuming the management of the Turkish Petroleum Co. would practice it." [41] He proposed that an independent commission be selected to handle the bids on outside areas, but nothing came of his suggestion.[42]

The "open door" is closed by the "self-denying clause."—Another question which the groups discussed at great length and which bore directly upon the "open door" plan was known as the "restrictive provision" or the "self-denying clause." This proviso was a carry-over from earlier agreements entered into by TPC, including, as noted earlier, the Foreign Office agreement of 1914. The Foreign Office agreement contained a proviso prohibiting the individual owners of TPC from being interested directly or indirectly in the production or manufacture of crude oil in the Ottoman Empire in Europe and Asia [43] "other than through TPC." [44] All the groups except the Americans had been parties to this agreement, and when the American group began negotiations in 1922 with TPC they were informed that this restrictive proviso would also apply to their activities. Thus, in a confidential memorandum of negotiations with the Turkish Petroleum Co. prepared by W. C. Teagle of Standard Oil Co. (New Jersey), there is the following statement:

> It was impressed upon me that if a participation by the American group is arranged, the group as a whole, as well as each individual company, would be

[40] Turkish Petroleum Co., Ltd. Convention with the Government of Iraq, March 14, 1925.
[41] Quoted from memorandum by Guy Wellman to W. C. Teagle, March 21, 1928.
[42] Ibid.
[43] Except in Kuwait and the "transferred territories."
[44] The three groups which at that time owned the Turkish Petroleum Co. were the D'Arcy group, acting for Anglo-Persian Oil Co., the Deutsche Bank, and Anglo-Saxon Petroleum Co., representing Royal Dutch-Shell.

required to undertake to be interested in this area only as shareholders in the Turkish Petroleum Co.

The American group, led by Standard Oil Co. (New York), opposed this proposed restriction on their freedom to compete for concessions, and during the early stages of the negotiations made various attempts to revise or eliminate the provision from the agenda. As originally proposed, the American group thought the "restrictive provisions" or "self-denying clause" applied only to production. But in 1923, when they discovered that marketing was also to be restricted, Standard Oil Co. (New York), made a vigorous protest on the grounds that it was an established and growing concern in all of what was formerly the Ottoman Empire, including Turkey in Europe and Asia, Syria, Palestine, and Mesopotamia, and that it had been established in these markets for many years prior to the formation of the Turkish Petroleum Co. It was willing to transfer its concessions in Palestine to the Turkish Petroleum Co. on some equitable basis, but it could not agree to refrain from seeking concessions in the future or to do anything that would imperil its established marketing organizations and existing rights in the affected territories.[45]

In July 1923, the board of directors of Standard Oil Co. (New York), discussed the possibility of eliminating altogether the proposed restrictive provisions which had been injected into the TPC negotiations. One official was of the opinion that his company (Standard of New York), would be injured in Turkey if it entered into any agreement not to be interested in production or refining other than through the TPC.[46]

Again, in August 1923, the American group rejected a proposal of the French that all participants in TPC share all future concessions obtained by any of them.[47] In commenting upon the French proposal and the reasons for its rejection, W. C. Teagle of Standard Oil Co. (New Jersey) expressed the view that agreement by the American group to such a proposal might be construed as "in violation of some of our antitrust laws."[48]

In July 1924, the owners of TPC suggested to the American group that the parties interested in TPC agree not to be interested in the production or refining of crude oil in Iraq otherwise than as shareholders in TPC or as sublessees under the "open door" plan.[49] This proposal was also rejected by the American group.

The American group continued to oppose any self-denying clause that would limit their freedom to act independently with respect to production or marketing in the area under the exclusive control of TPC or in the "outside areas" which were to be available for sub-

45 From memorandum dated December 14, 1922.

46 Memo from Guy Wellman to W. C. Teagle, July 25, 1923.

47 Letter from H. E. Nichols to W. C. Teagle, July 25, 1923.

48 In a letter from W. C. Teagle to Mr. Finaly dated September 5, 1923, Mr. Teagle wrote as follows: "This request was not acceptable to either of the British partners and was impossible of acceptance by the American group for the reason that the group, as you know, is composed by a half dozen independent American oil companies who have agreed to act as a unit in Mesopotamia, but with absolutely no agreement in regard to joint cooperation in any other area. To accede to this request would have meant that the interest of the various members of the American group, in producing properties outside of the United States, would have to be pooled, which, even though it had been agreeable to all the members of the group, would, I am afraid, have been impossible of accomplishment from the standpoint of the possibility of its being construed as in violation of some of our antitrust laws."

49 Letter from H. E. Nichols to W. C. Teagle dated July 28, 1924. The proposal was as follows: "The signatories shall not be interested in the production of crude oil in the area at present administered by the Iraq Government otherwise than as shareholders or as sublessees in the open-door plan of the Turkish Petroleum Co. and shall not be interested in the refining of oils within the same area otherwise than as shareholders of the Turkish Petroleum Co. provided that this restriction shall not apply to the transferred territories and shall not apply to the refining of any product which the Turkish Petroleum Co. is not at that time in a position to refine."

leasing.[50] But as negotiations dragged along, opposition by the American group to any and all restrictive policies began to weaken. It will be recalled that in March 1925 TPC had signed a concession agreement with the Iraq Government validating the claims of TPC. This action reduced the bargaining position of the American group since they could no longer threaten to go into Iraq, obtain a concession on their own, and thereby cut the ground from underneath TPC.[51] Also, there was less incentive for the American companies to oppose the self-denying clause. Production had more than doubled from 1918 to 1925, Venezuela was developing as an important oil-producing country, and all talk of an oil shortage in the United States had disappeared.[52]

During 1925 and 1926 negotiations between the parties had reached an impasse. Gulbenkian and the French (CFP), had raised issues which the parties could not readily reconcile. However, in October 1926 the geologist of Standard Oil Co. (New Jersey), who had been making explorations in Iraq, rendered a very optimistic report regarding the oil possibilities there. Standard then began a new effort to reach a settlement.

This was not an easy accomplishment, however, because of certain frictions which had arisen between the various parties. Thus, a wide breach had developed in the relations between the French (CFP), and the British groups. Royal Dutch-Shell had taken the position that the prewar Foreign Office agreement of 1914 was not binding on the groups and had obtained a concession in the Farsan Islands,[53] which, in view of the French, were within the area covered by the self-denying clause of the Foreign Office agreement of 1914. The French contended that this concession should be held by TPC for the benefit of all the groups, and brought suit in the English courts to enforce the demand. There had also been a definite break in relations between Gulbenkian and Sir Henri Deterding,[54] which made it still more difficult for the parties to reach an agreement.

The insistence upon the inclusion of a self-denying clause in the agreement came principally from the French and Mr. Gulbenkian. The French group (CFP) and Gulbenkian insisted that all the parties

[50] The position of the American group with respect to the self-denying clause in November 6, 1924, is shown by the following quotation from a letter from W. C. Teagle to Mr. Guy Wellman, London. Mr. Teagle wrote as follows: "You will have in mind that the American group not only have declined up to date to take up their share interest in the Turkish Petroleum Co. pending the definite grant of a concession by the Iraq Government, but what is of even more importance, have not up to date agreed to the self-denying ordinance. In other words, insofar as the American group is concerned they have not, as yet, agreed to restrict their operations in what was formerly Turkey in Asia exclusively to the Turkish Petroleum Co., and, therefore, their position in this regard is entirely different from that of the existing shareholders in the Turkish Petroleum Co. who are already bound by the self-denying ordinance contained in the articles of association of that company."

[51] That the American group considered the possibility of an independent concession in Iraq is indicated by the following quotation from a cable sent by Heinrich Riedemann and Guy Wellman to W. C. Teagle on November 10, 1924: "We do not believe American group has any chance at this late hour to obtain independent concession * * * in view of political situation in Iraq."

[52] An indication that the American position was weakened in regard to the adoption of a self-denying clause is indicated by the general tone of the correspondence between the representatives of Standard Oil Co. (New Jersey), who were primarily responsible for conducting the negotiations with TPC. Mr. Guy Wellman, in commenting upon the proposal to adopt a self-denying clause, stated in a memorandum to the members of the American group in July 1925 that "the principal reason for having such a provision was as much in the interest of international peace as in the economic interests of any group." It was his view that if there was an international scramble between France, the United States, and Great Britain for oil concessions in Turkey, it would revive much of the danger which developed through the debates in Congress and in the press regarding the "open door" in Mesopotamia, and if the groups in TPC cooperated, that danger would be avoided. He also believed that the selfish interests of the American group would be served by joining TPC with a self-denying clause because the French and the British would stand a better chance of getting any desirable oil concessions in Turkey than the Americans.

[53] These islands are located in the Red Sea off the coast of Yemen.

[54] The intense ill feeling which developed between Sir Henri Deterding and Gulbenkian appears to have arisen over a dispute regarding Gulbenkian's interest in Venezuelan Oil Concessions, Ltd., a Shell subsidiary. Gulbenkian charged that Royal Dutch-Shell was attempting to defraud him as a minority stockholder of Venezuelan Oil Concessions.

in TPC be bound by the Foreign Office agreement of 1914, and that this agreement cover not only the former Ottoman Empire but also the "outside areas" under the TPC concession with the Iraq Government. These "outside areas" were concession areas that were not reserved for exclusive exploitation by TPC, but were to be opened for competitive bidding. The French and Gulbenkian maintained that no shareholder in the TPC could be interested in any of the "outside areas" under the Iraq convention except through TPC. The French also contended that the limitation of TPC's exclusive exploitation rights to only 24 plots of 8 square miles each was not in compliance with the San Remo agreement, which gave them rights to 25 percent of all crude oil that might be produced in Mesopotamia. However, they were willing to compromise this point in return for a self-denying clause similar to the one included in the Foreign Office agreement of 1914.

Offers and counteroffers passed back and forth, with the American group taking the position that the self-denying clause, as demanded by the French, would nullify the "open door" scheme.[55] However, the French, who had the support of the French Cabinet, were insistent that all groups accept a self-denying clause. Behind this attitude was the realization that they could not afford to be put in the position of standing alone in the competitive bidding for any "outside areas" covered by the concession. Moreover, they anticipated receiving enough oil from Iraq to become independent of all other suppliers.[56]

The persistence of the French and Gulbenkian, coupled with a weakening of the opposition by the American and British groups, eventually led to a compromise which retained most of the force of the self-denying clause. Specifically, this clause was not to apply to the American group or its members, insofar as "outside areas," i. e., areas within the TPC concession that were open for competitive bidding, were concerned, but would apply to the American group in *other territories* that were formerly in the Ottoman Empire. Along these lines, an agreement was finally reached.[57]

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[55] A further indication of the softening of the American opposition to the adoption of a self-denying clause is shown by a memorandum from Guy Wellman to the American group dated March 31, 1927. Mr. Wellman, who was assistant general counsel of Standard (New Jersey), and one of the principal negotiators for the American group, expressed the view that "From the standpoint of the 'open door,' the pooling by the four groups of the outside areas would not be an essential modification," the reason being that other American nationals would be free to bid for outside areas as though this arrangement were not in effect; moreover, that such an arrangement would be more economical than if scattered areas were operated by different companies. Mr. Wellman indicated that he had privately favored for some time the essence of the self-denying ordinance.

[56] Letter from M. Piesse to W. C. Teagle, July 5, 1927.

[57] A significant development which undoubtedlyacted as a powerful incentive toward a reconciliation of differences between the groups was the bringing in, on October 15, 1927, of an oil well in Iraq which flowed at the rate of from 50,000 to 100,000 barrels per day for several days. There was a plentiful supply of oil everywhere, and the potentially large new supply that now loomed in Iraq may have been an added inducement for the parties to give up some of their independence and try to reach an agreement, not only in respect to TPC, but also in respect to problems in India and elsewhere. In 1927, Standard Oil Co. (New York), and Royal Dutch-Shell were engaged in a price war in India and there was intense feeling between Sir Henri Deterding and the officers of Standard Oil Co. (New York). Some indication of the nature of the problem is indicated by a letter dated October 10, 1927, from Sir Henri Deterding to Heinrich Riedemann, Standard Oil Co.'s (New Jersey) European representative. Mr. Deterding wrote as follows:

"The Turkish Petroleum Co. struck it rather rich, or better, exceedingly rich; namely the first deep well has come in with 50,000 barrels per day! Now that the Jersey Co. is to become our partner in this venture, I hope Teagle will arrange shortly that the Jersey company will look after her own production and selling arrangements, instead of leaving it to the New York company who is more concerned to satisfy the temper of Meyer than to do justice to her shareholders and protect the interest of her principals for whom she is supposed to sell oil at the best price, although in fact (Dutch Indies) she purposely sells the Jersey products (from Palembang field) at a low price as a retaliation of the low prices in British India.

"There is another and perhaps more serious matter to consider. The new production will give rise and opportunity to discussions involving big views and principles. * * * We are facing now such enormous events that the Jersey Co. should settle these things herself. * * *"

In October 1927, the French presented a map of the Middle East on which they had outlined in red the area they considered to be the former Ottoman Empire—the area to which the self-denying clause should apply.[58] Although the British groups did not regard the map as historically accurate, they were willing to accept it for the purpose of an agreement between the parties. The American group also accepted, with Gulf entering a reservation as to whether the American group, and particularly Gulf, might not obtain more oil in the Ottoman Empire if the self-denying ordinance were omitted. Standard Oil Co. (New Jersey), however, thought that it was a case of take it or leave it, and that if additional production were found outside of Iraq, the self-denying clause would benefit rather than harm the interests of the American group.[59] Moreover, the Americans were also now beginning to recognize that if all other groups were bound under a self-denying clause while they were left free, the other groups would be able to outbid the Americans for outside areas, since, under the TPC agreement, "they would lose only one-fourth of the amount paid for a plot and the balance would be returned to them by TPC.[60]

The acceptance of this slightly-qualified self-denying clause went a long way toward closing the "open door." In fact, for the participating companies, the "open door" was completely closed, not only in the Iraq concession area but in the whole Ottoman Empire. With respect to "outside areas," the American group did get a special provision inserted in the group agreement permitting them to apply for subleases on "outside areas" [61] and, if obtained, the plots could be operated or disposed of for their own account.[62] But this was more or less a gesture since, before the Americans could select a plot, they had to give 30-days notice to TPC of their intention to apply and then wait 10 days to see if any of the other groups in TPC proposed to make a tender on the plot. Thus, the other groups were in a position, either individually or collectively, to outbid the Americans and otherwise make it quite difficult to obtain plots independent of TPC control. Moreover, since the TPC would handle both the bids and the granting of awards, TPC became judge and jury with regard to concessions in the outside areas. Hence, when the American group, after 6 years of negotiations, took up its share in TPC in July 1928, the "open door"

[58] This was the area bordered in red on the map inserted after this page.

[59] Letter from Guy Wellman to Montague Piesse, March 22, 1928.

[60] Cable, Guy Wellman to Montague Piesse, August 25, 1927. This was so because under the TPC Convention, the money paid by successful bidders for any outside area would be received by TPC which would distribute it to its shareholders. The other three groups, therefore, could outbid the Americans, if they remained outside the self-denying clause, with the knowledge that the sum they paid to TPC would be divided four ways, i. e., three-fourths of the money would be returned to the three of them, while one-fourth would be paid or lost to the Americans. On the other hand, if the Americans were the successful bidders, only one-fourth of the money paid would be returned to them and the balance, three-fourths, would be lost to the other three groups. Thus, under the mechanics of the TPC convention, the Americans, if they alone remained outside the self-denying clause, could be outbid on every occasion by the others.

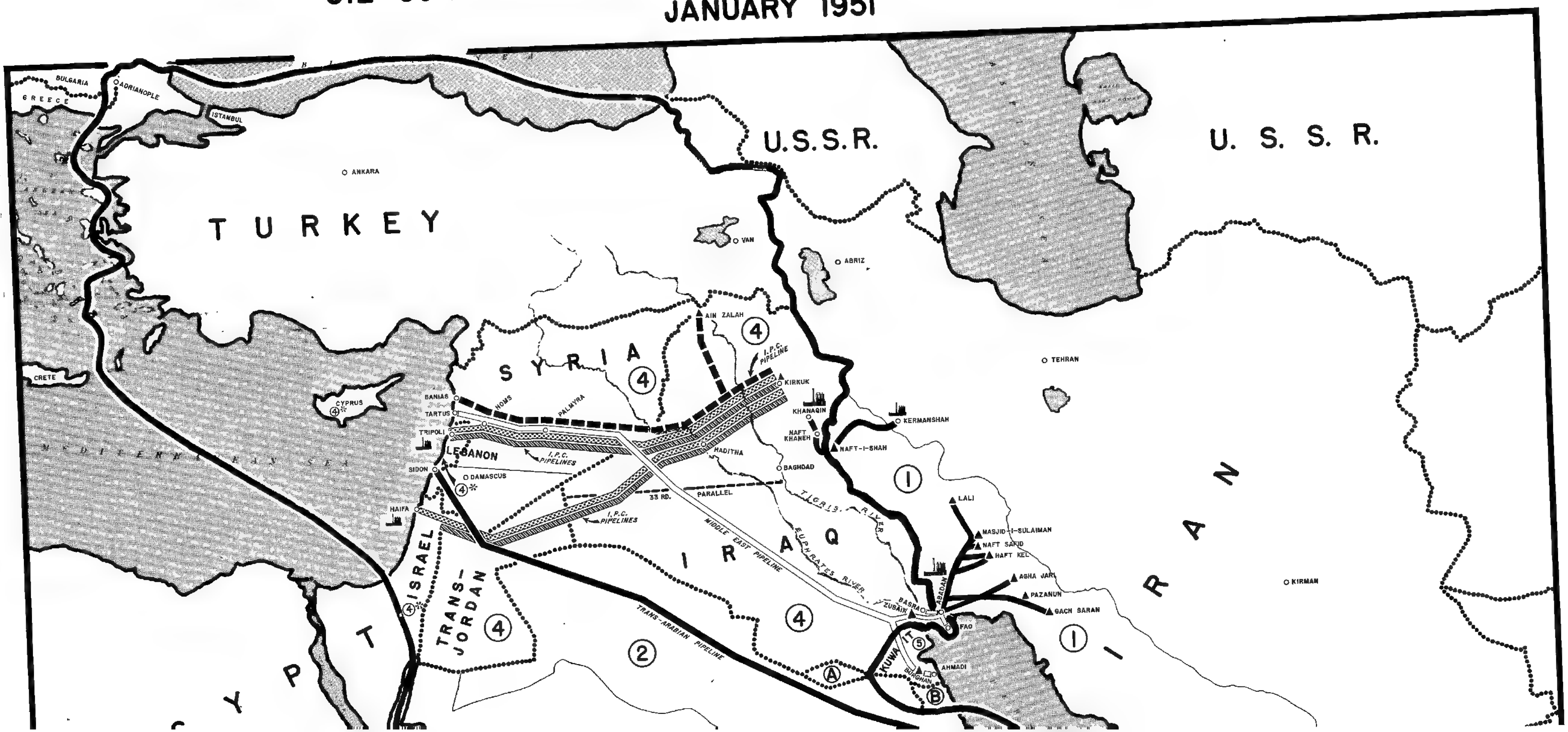
[61] Article 6 of the Iraq convention of March 14, 1925, contained the following provision with respect to the "open door:"

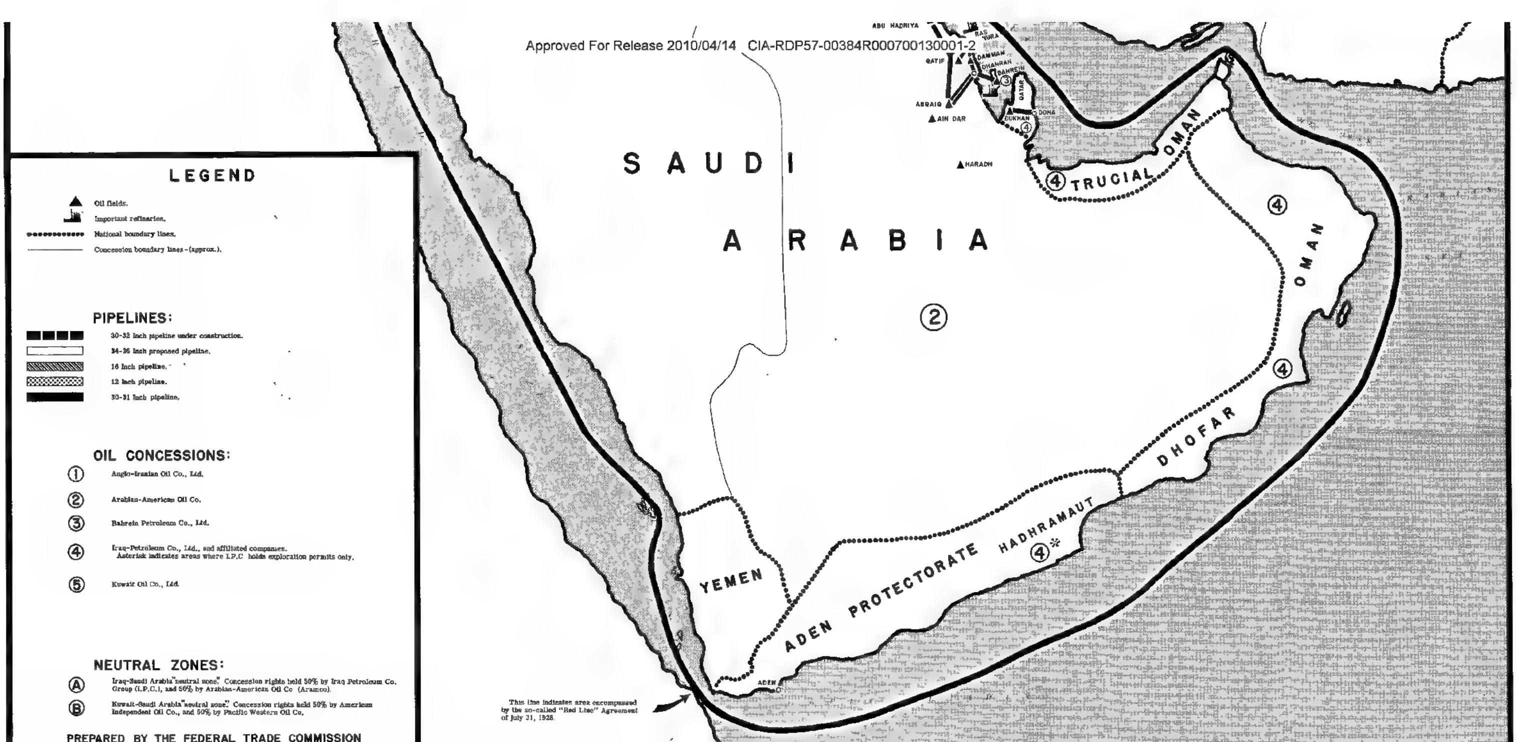
"The Government shall, not later than 4 years after the date of this Convention, and annually thereafter, select not less than 24 rectangular plots, each in an area of 8 square miles, and the Government shall offer the same for competition, by sealed tender, between all responsible corporations, firms, and individuals, without distinction of nationality, who desire leases. Both the company and any such prospective lessee may indicate any plots * * * to be offered among such 24 and the same shall be offered accordingly by the Government."

[62] The special provision was as follows:

"The American Company and any of its Associated Companies shall as regards any plot offered for competition under Article 6 of the Iraq Concession be entitled to apply for and obtain a lease thereof and if successful it shall * * * not be bound to transfer such plot to an Operating Company but shall be entitled to retain and develop or dispose of the same for its own account. But the American Company or any of its Associated Companies before so acting shall thirty days before the date fixed for the loosing of the tenders give notice in writing to the Turkish Company that it intends to avail itself of the provisions of this clause and shall then within ten days thereafter be entitled to receive similar notice from such of the other Groups as propose to put in tenders pursuant to clause 10 hereof." From article 11 of the group agreement of July 31, 1928.

OIL CONCESSIONS AND FACILITIES IN THE MIDDLE EAST
JANUARY 1951




SAUDI ARABIA
YEMEN
ADEN PROTECTORATE
HADHRAMAUT
DHOFAR
OMAN
TRUCIAL OMAN
QATAR
ADEN
ABU HADRIYA
QATIF
DHAHRAN
BAHREIN
ABQAIQ
AIN DAR
DUKHAN
DOHA
HARADH
LEGEND
Oil fields.
Important refineries.
National boundary lines.
Concession boundary lines-(approx.).
PIPELINES:
30-32 Inch pipeline under construction.
34-36 Inch proposed pipeline.
16 Inch pipeline.
12 Inch pipeline.
30-31 Inch pipeline.
OIL CONCESSIONS:
① Anglo-Iranian Oil Co., Ltd.
② Arabian-American Oil Co.
③ Bahrein Petroleum Co., Ltd.
④ Iraq-Petroleum Co., Ltd., and affiliated companies. Asterisk indicates areas where I.P.C holds exploration permits only.
⑤ Kuwait Oil Co., Ltd.
NEUTRAL ZONES:
Ⓐ Iraq-Saudi Arabia "neutral zone." Concession rights held 50% by Iraq Petroleum Co. Group (I.P.C.), and 50% by Arabian-American Oil Co (Aramco).
Ⓑ Kuwait-Saudi Arabia "neutral zone." Concession rights held 50% by American Independent Oil Co., and 50% by Pacific Western Oil Co.
PREPARED BY THE FEDERAL TRADE COMMISSION
This line indicates area encompassed by the so-called "Red Line" Agreement of July 31, 1928.

was, for all practical purposes, closed to the partners of TPC. In reality, they could now act only through TPC—a joint venture in every sense of the word.[63]

The working agreement and the Gulbenkian controversy.—As a condition for participation in TPC, the American group insisted that a "working agreement" be adopted which would control the internal policies and operations of TPC. The American group presented a general outline of the working agreement when negotiations with TPC first began in 1922. Thereafter, and until the group agreement of 1928 was signed, the working agreement was one of the unsettled issues which had to be resolved by the parties interested in TPC.

Two basic considerations led the American group to formulate the working agreement. First, the Americans did not want TPC to compete with existing oil companies,[64] and second, they wanted to avoid payment of taxes to the American and British Governments on the earnings of TPC.[65] These objectives could best be accomplished by the operation of TPC as a non-profit-making company. Hence, the draft working agreement provided that TPC should be a non-profit-making enterprise, with each shareholder taking its pro rata share of the crude oil produced at a price sufficient only to cover cost of production, transportation, and a nominal profit—the profit to be limited to a reasonable return on investment.[66]

This proposed agreement ran up against an unexpected barrier in the person of Mr. Gulbenkian. Throughout the early stages of their negotiations with TPC, the American group had not been greatly concerned about Gulbenkian's 5 percent interest in the company.[67] It was believed that a settlement could be arranged with him on an equitable basis. Under these circumstances, the American group was somewhat surprised to find in July 1924, at a time when they were practically ready to sign a convention agreement with the Iraq Government, that Gulbenkian was an obstacle to carrying out the working agreement. Gulbenkian's position was based upon the simple fact that he had no refining or marketing facilities or any type of organization to handle crude, and hence was not interested in having

[63] There is some basis for believing that in the later stages of the discussion with TPC, the American group's insistence upon the "open door" policy did not reflect a conviction that practical commercial benefits would accrue under the "open door" plant. In January 1927, E. J. Sadler, Standard Oil Co. (New Jersey), wrote to W. C. Teagle of Standard (New Jersey), as follows:

"The effect of the American group participating in the Iraq Petroleum Co. would probably be to quiet all opposition to the Iraq Petroleum Co's. accomplishing the practical monopoly of producing operations in Iraq. I mean by this that they would probably get extensions of time for selecting their land and possibly accomplish other things outside the terms of the concession if there were no serious opposition."

Again in March 1928, Sir Adam Ritchie, acting managing director of TPC, wrote to the partners in TPC in the following vein:

"The general view of the British advisers and the Iraq ministers is that it has never been contemplated that any other interest will compete with us in Iraq."

The implication of such statements appears to be that the "open door" would not be made available to any oil company other than the partners in TPC.

[64] The American group's position on this point is well summarized in an interoffice communication from W. C. Teagle to S. B. Hunt dated January 13, 1923. Mr. Teagle stated:

"As I see the situation, it is not the desire or intention of the American group to obtain a participation in the Turkish Petroleum Co., Ltd., and after obtaining same to set up the Turkish Petroleum Co. and finance it to create a new organization in direct competition with the organization already created by the partners of the TPC."

[65] In commenting upon the limitation of TPC profits, W. C. Teagle wrote as follows to A. C. Bedford on November 13, 1923:

"To refresh your memory, I would recall that the real reason for inserting this limitation of profits was so that the American group might, to the extent possible, avoid payment of two income taxes, i. e., the tax payable by the TPC to the British Government, and second, the tax payable by the American group to their own Government."

[66] There were other provisions of the working agreement relating to pipelines, acceptance of the oil at the terminals, voting arrangements within TPC, etc., but the significant feature was that part of the working agreement which provided for operating TPC as a non-profit-making company.

[67] It will be recalled that under the Foreign Office Agreement of 1914, Gulbenkian's 5 percent interest in TPC was held in trust for him by Anglo-Saxon and Anglo-Persian, each to contribute 2½ percent for his benefit.

his pro rata share of crude produced at a nominal profit by TPC. Rather, he wanted TPC to be operated for maximum profits.

In their desire for the working agreement, the Americans were supported by the French (CFP), who wanted to obtain as much crude as possible and become independent of the large oil companies. The British groups, Anglo-Persian and Anglo-Saxon, were indifferent to the working agreement because they would be liable for British income taxes in any event, and the working agreement was of no real advantage to them. All the proposed shareholders except Gulbenkian were, however, in a position to take the crude produced by TPC into their integrated refining and marketing organizations and obtain profits from transportation, refining, and marketing. Thus, the working agreement was viewed by Gulbenkian as a means devised by the large oil companies to deprive him of the benefits of his share interest in TPC.

Many offers and counteroffers were made in an attempt to reach an agreement with Gulbenkian which would permit the American group to participate in TPC and adopt the working agreement. In 1924, Gulbenkian threatened to obtain an injunction to restrain TPC from putting into operation the working agreement, which he alleged was a fraud upon his minority interests.[68] The American and British groups attempted to have their respective Governments bring diplomatic pressure upon Gulbenkian, but to no avail.[69] Gulbenkian countered with an offer to accept arbitration by a high British official, and from that time onward until an agreement was reached, the negotiations were conducted on the basis of reaching an agreement with Gulbenkian rather than eliminating him from TPC.

In addition to a refining profit from the operations of TPC, Gulbenkian wanted a share in any outside plots which were to be subleased. Under the "open door" provision applicable to the outside areas, the benefits of Gulbenkian's 5-percent interest would have been limited to the 24 plots reserved for the exclusive exploitation by TPC under the Iraq Convention. Thus, Gulbenkian became a strong advocate of the self-denying clause in order to extend the area from which he would be able to enjoy the benefits of his 5-percent interest. Moreover, he insisted from time to time that the word "manufacture" be included in the self-denying clause so that all refining operations would be conducted by TPC, thus enabling him to obtain refining profits. He also contended that if he sold his crude, he should get a price which would include a refining profit.

At one time, the Americans believed that they had reached an impasse and threatened to withdraw from negotiations with Turkish Petroleum Co. unless the British groups were able to induce Gulbenkian to agree to the working agreement. Later, however, the Americans agreed to join TPC without the working agreement, but the French were not willing to admit the Americans on this basis. After various moves and countermoves, the French (CFP) induced Gulbenkian to agree in 1927 to adopt the working agreement provided

[68] In September 1924, Guy Wellman, associate general counsel, Standard Oil Co. (New Jersey), who was then in London conducting negotiations with TPC, advised Mr. Teagle, of Standard Oil Co. (New Jersey), as follows:

"We cannot pass the working agreement and the 'open door' plan leaving Gulbenkian a simple share interest in the TPC and expect to prevail against Gulbenkian in the courts."

[69] The British Foreign Office took the view that the dispute between the parties was purely a business matter and refused to intervene, but it agreed to use its good offices to obtain an agreement, believing that Gulbenkian had some rights which the group should recognize and meet fairly. Cable from Guy Wellman, London, to U. S. State Department, October 15, 1924.

the French would purchase Gulbenkian's pro rata share of the crude produced by TPC.[70] The French asked the other three major groups to join them in purchasing Gulbenkian's oil. The Americans were at first reluctant to do so, but finally the British and American groups secretly agreed with CFP to share the purchase.[71] The settlement with Gulbenkian made in July 1928, with the signing of the group agreement, included all the provisions of the working agreement that made TPC a nonprofit company.

Anglo-Persian's overriding royalty and the American group's share interest in TPC.—To become a partner in TPC, the American group had to receive a portion of the stock of TPC. The question of how much this share should be and from whom it should be obtained, arose early in the discussions between the Americans and the original owners of TPC. In the ensuing negotiations, the proposed solution, an overriding royalty for the principal shareholder, Anglo-Persian, was directly related to the American group's share participation.

When the American representatives held their first meetings with the owners of TPC in 1922, they stated that the minimum participation acceptable to them would be 25 percent. In general, they held that their participating share should at least be equal to that held by the French (CFP), and Anglo-Saxon (Royal Dutch-Shell). As a compromise proposal to the American group's demands, Sir Henri Deterding, of Royal Dutch-Shell, proposed that Anglo-Persian cede to the American group one-half of its 50-percent participation, and thereby equalize the holdings of all groups at 25 percent each. As compensation, Anglo-Persian would be granted an overriding royalty not to exceed 6 shillings per ton.[72] In this way, the American share participation in TPC became linked to an overriding royalty for Anglo-Persian. But Anglo-Persian rejected Deterding's proposal on the grounds (1) that the compensation was inadequate for relinquishing one-half of their holdings and (2) that they were more interested in obtaining crude oil than in a money payment.

Shortly thereafter, a counterproposal was made by Anglo-Persian which provided that the Americans would be offered a 20-percent participation, to be obtained by a pro rata reduction in the holdings of the three large shareholding groups in TPC. Under this proposal, Anglo-Persian's interest would have been reduced from 50 percent to 40, and the French (CFP), and Anglo-Saxon (Shell), interests from 25 to 20 percent each. This proposal, however, was not acceptable either to Shell or the French (CFP). The French (CFP); took the

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[70] At the time the group or red-line agreement of July 31, 1928, was signed, CFP signed a separate agreement with Participations & Investments, Ltd. (Gulbenkian), under which CFP agreed to purchase Gulbenkian's share of crude oil or refined products that he might obtain from TPC. The price which CFP was to pay was to be determined by experts selected by CFP and Gulbenkian, and was to be a fair and reasonable price as represented by the average of the world market prices prevailing in January and in June at the port of shipment. Also, in the event CFP decided to construct a refinery, Gulbenkian was to have the option of obtaining a share interest in the refinery.

[71] On March 4, 1929, Anglo-Persian (D'Arcy Exploration Co.), Royal Dutch-Shell (Anglo-Saxon Petroleum Co., Ltd.), and the American group (Near East Development Corp.), made an agreement with CFP which provided that the first three parties should not have any dealings with Gulbenkian for the purchase of any of his oil or refined products. All dealings with Gulbenkian were to be handled by CFP in consultation with the other parties, but all four parties agreed to share equally in any benefits accruing to CFP from the Gulbenkian arrangement. CFP was to deliver to Anglo-Persian, Royal Dutch-Shell, and the American group one-fourth of the crude oil or refined products which CFP obtained under the Gulbenkian agreement and to pay to CFP one-fourth of the sum which it had to pay to Gulbenkian. In other words, the arrangement was a means whereby Anglo-Persian, Royal Dutch-Shell, and the Americans would reimburse CFP for the costs incurred in carrying out its agreement with Gulbenkian. A further proviso in the agreement provided that CFP should not contract for any refinery such as might be constructed under CFP's agreement with Gulbenkian without the consent and approval in writing of Anglo-Persian, Royal Dutch-Shell, and the American group. For some time, this agreement was kept secret from Gulbenkian.

[72] Shell and CFP both pushed the idea of equality of holdings. Shell was especially concerned that Anglo-Persian not be in a position where, in conjunction with another group, it could control TPC.

position that it would be hard for the French people to understand why their participation, awarded under the San Remo agreement, should be reduced. Subsequently, the three owners of TPC, Anglo-Persian, Anglo-Saxon (Shell), and the French (CFP), informed the American group that the absolute maximum of participation which they could cede to the Americans was 12 percent. This offer was flatly rejected by the Americans as unacceptable, and for a few months negotiations were practically at a standstill.

Late in 1922, the question was reopened by another offer to the American group from the partners in TPC. Under this proposal, each of the major partners of TPC—Anglo-Persian, Shell, CFP, and the American group—were to have a 24-percent interest, while Gulbenkian would hold a 4-percent nonvoting interest. As consideration for the reduction of its shareholdings, Anglo-Persian was to receive a royalty of 10 percent of the crude oil produced from the concessions, delivered into the pipeline free of all cost.[73] The American group questioned the 10 percent overriding royalty and also the reduction of the American share to make allowance for Gulbenkian's interest. The British groups (Shell and Anglo-Persian), insisted that the American group accept pro rata responsibility for Gulbenkian's holdings, but the Americans rejected this on the ground that under the Foreign Office agreement, Anglo-Persian and Anglo-Saxon (Shell), were responsible for Gulbenkian's share interest in TPC. The American group was also concerned about the area to which the 10 percent overriding royalty would apply. Was it to apply to the oil from the entire concession, including "the outside areas," or only to the crude oil produced by TPC on the 24 plots?

When the parties became entangled in the long discussion with Gulbenkian in 1923–26, the respective share interests of the various parties and the size of the Anglo-Persian royalty became issues for negotiation. Gulbenkian was opposed to the 10-percent overriding royalty, which he believed was a contribution to Anglo-Persian for which he would receive no benefit. Later, however, Gulbenkian agreed to let Anglo-Persian have the 10 percent of free oil if, in return, Anglo-Persian and Royal Dutch-Shell would accept the Foreign Office agreement of 1914. The French were also reluctant to agree to Anglo-Persian's 10-percent overriding royalty. CFP at first attempted to obtain a one-half percent royalty from Shell in return for a 1¼ percent share interest in TPC. Shell rejected the CFP request. When the parties agreed to accept the self-denying clause of the Foreign Office agreement of 1914, CFP gave up its demands for a royalty.

In the final settlement, all parties agreed to give Anglo-Persian a 10 percent overriding royalty on all oil obtained from the 24 plots which were reserved for exclusive exploitation by TPC. The American group obtained a 23.75 percent interest in TPC, and Anglo-Persian, and Royal Dutch-Shell agreed to be responsible for Gulbenkian's 5 percent interest,[74] which reduced Anglo-Persian's interest to 23.75 percent and Royal Dutch-Shell's interest to 22.50 percent.

[73] This offer, however, was made contingent upon the American group's obtaining an acknowledgment from the State Department that the offer would satisfy all American claims in Iraq, and that the State Department would no longer question the validity of the titles held or claimed by the TPC. But the State Department and the American group would not go along with the British proposal, and insisted that TPC's claims had to be confirmed by the Iraq Government.

[74] This was in accordance with the provisions of the Foreign Office agreement.

CFP then agreed to give a 1¼ percent share in TPC to Royal Dutch-Shell (thus equalizing the American, French, Anglo-Persian, and Shell's interest at 23.75 percent each), and to purchase Gulbenkian's share of TPC oil. Such was the division of the share interests effected by the group agreement of July 31, 1928.

THE SCOPE OF THE RESTRICTIVE PROVISIONS OF THE GROUP (RED LINE), AGREEMENT OF 1928

The group or "red line" agreement of July 31, 1928, which was thus worked out, constituted a partnership under which TPC became "a brotherhood of oil merchants." [75] The production, offering, dividing, and selling of crude oil was carried on by TPC at a price to cover its cost. Hence, profits accrued to the partners, and not to TPC.[76] The agreement was essentially a compact between the owners of TPC and the corporation itself, but most of its provisions concerned the interrelations of the component groups. Each of the parties (owners), was in contract with each other,[77] and each owner was bound to see that any associated companies which were controlled directly or indirectly by the respective owners, observed the agreement.[78]

The agreement compromised most of the principal issues which had existed among the different groups. Thus, it admitted the Americans to TPC as a full partner along with Anglo-Persian, Royal-Dutch-Shell, and CFP;[79] it put into effect the working agreement which made TPC a nonprofit crude oil distributing company;[80] it gave Anglo-Persian a 10 percent overriding royalty on all crude produced from the 24 plots to be selected in accordance with the Iraq concession agreement of March 14, 1925; it required TPC to construct a pipeline to the Mediterranean as soon as sufficient oil had been secured to justify a pipeline.

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[75] Letter from J. Skliros, managing director of TPC, to the groups, June 5, 1934.

Close cooperation was required of the groups in the administration and management of TPC. Each group holding a 23.75 percent share was termed a major group and each major group was entitled to appoint two directors. Participations and investments (Gulbenkian) was termed a minor group and entitled to one director. (Any appointed director could select an alternate director). In addition to the directors appointed by the groups, one director could be appointed by the Government of Iraq; the TPC Board could elect a chairman and a managing director, but the number of directors could never exceed 12, and resolutions could be passed at a board meeting only if 3 major groups voted favorably:

[76] From a memorandum prepared by Montague Piesse, April 21, 1944.

[77] Article 1 (i) reads as follows:

"Each of the parties hereto of the five parts hereby contracts with each of the other of such parties and with the Turkish Company that they will observe and will procure their respective Associated Companies (as hereinafter defined) to observe the provisions of this Agreement and each of the said parties shall be responsible for any breach or nonobservance of this Agreement committed by any Associated Company of such party in the same manner and to the same extent as if such breach or nonobservance had been committed by such party itself."

[78] Article 1 (iii) states that:

"In this Agreement the expression 'Associated Company' as regards each of the parties hereto of the first five parts means and includes (a) Any Company over which such party either alone or in conjunction with any other party or parties hereto and/or in conjunction with one or more Associated Companies of any party hereto can now or hereafter exercise control either directly or indirectly and whether such control be exercisable by means of the possession of a majority of votes or of the right of appointing directors or by contract or in any manner whatsoever whether similar to the above or not."

[79] As finally redistributed, the 5 owners held stock in the following proportions:

	Percent
D'Arcy Exploration Co., Ltd	23.75
Anglo-Saxon Petroleum Co., Ltd	23.75
Compagnie Française des Petroles	23.75
Near East Development Co	23.75
Participations and Investments Co	5.00

[80] Article 13 of the agreement provided that all crude oil produced or purchased by TPC was to be offered to the groups in "basic proportions," at seaboard terminal, at a price equivalent to cost plus a charge to be fixed by the board of directors of TPC not to exceed 5 shillings per ton. ("Basic proportion" was the proportion which the aggregate nominal value of the shares in TPC held by each group bore to the total nominal value of all the shares held by all the groups.) Although the agreement provided certain broad criteria for determining the price, it should be noted that under an arrangement completed in 1934, the effective price was a nominal price sufficient to cover allowances under the British income tax plus 1 shilling per ton profit.

The agreement wove around the groups a web of restrictive provisions that made it impossible, for all practical purposes, to compete in production, refining, or securing concessions in the "defined area," [81] an area which encompassed most of the old Ottoman Empire. Indeed, the prevention of competition was the sole purpose of many of the principal provisions. Thus, the TPC was to have the sole right to obtain oil concessions in the defined area, and the owners as well as their associated companies, i. e., subsidiaries controlled by the owners, were not to be interested, directly or indirectly, in the production or purchase of any oil in the "defined area" otherwise than through TPC.

Article 10 of the agreement regarding production and concessions is as follows:

> All the parties hereto agree that the Turkish Company or a nominee of the Turkish Company shall, except as hereinafter mentioned, have the sole right to seek for or obtain oil concessions within the defined area, and each of the Groups hereby covenants and agrees with the Turkish Company and with the other Groups that excepting only as herein provided or authorized such Group will not nor will any of its Associated Companies either personally or through the intermediary of any person, firm, company, or corporation seek for or obtain or be interested, directly or indirectly, in any such oil concession or be interested, directly or indirectly, in the production of oil within the defined area or in the purchase of any such oil otherwise than through the Turkish Company or an Operating Company under the Turkish Company.

The legal rigidity of this comprehensive restriction on the freedom of the groups to obtain concessions was slightly softened by two provisions. The first dealt with plots offered for competition (sublease) under article 6 of the Iraq concession,[82] and the second related to concessions in all other areas. If the groups unanimously agreed, a nominee on behalf of the groups was permitted to tender a bid for a lease on plots offered under article 6 of the Iraq convention, but if the nominee were successful in acquiring the lease then each partner (group), was entitled to be offered its proportionate share in the concession.[83] On the other hand, if the groups were not unanimously in favor of tendering a bid, the group or groups favoring such action were free to bid, but if they obtained the concession, it was to be transferred immediately to a company in which each of the groups would be offered its proportionate share interest. A similar rule applied to all concession areas other than those under article 6 of the Iraq concession. If TPC did not wish to apply for a concession but two groups thought otherwise, then TPC would permit the groups to bid for the concession, but if the bid was successful, each of the other groups was to be offered its proportionate interest.[84]

Only under these limited circumstances could the groups bid for concessions independently of TPC. The practical effect of these escape clauses was negligible because the "share and share alike" provisos offset most of the advantage that might be obtained by independent action.

[81] The "defined area" was bordered in red on a map which was included as an attached schedule to the agreement. The area circled by the red line included Turkey in Europe, Turkey in Asia (which comprised Anatolia, Arabia, Syria, Palestine, Mesopotamia, and Kurdistan), and certain islands in the Mediterranean. Generally, the "defined area" was assumed to include the old Ottoman Empire excluding, however, the Sheikdom of Kuwait.

[82] In previous sections, these plots were called "outside areas."

[83] The American group was permitted to operate these plots on their own behalf if obtained. See p. 60,

[84] Art. 10 (i) of group agreement of July 31, 1928.

The freedom of the groups to perform refining operations independently was restricted in much the same manner as their right to seek concessions and engage in production. Under the Iraq concession, TPC was obligated to refine or supply oil to meet the local needs of the Iraq Government. In regard to this point, the red-line agreement provided that only TPC should refine oil in Iraq and that the quantity should not be in excess of Iraq consumption.[85] There was to be no surplus for export. Moreover, the groups were permitted to erect and operate refineries at seaboard terminals only if all the major groups gave their consent in writing, and then only for the purposes of (1) refining such Iraq oil as the groups did not purchase or (2) refining oil on account for any or all groups. In the latter instance, each would be entitled to have its proportionate share of the oil refined while in the former, the refined products obtained from Iraq crude had to be shared on equal terms in the "basic proportions."[86]

It should be noted, however, that the red-line agreement was concerned principally with protection of supply rather than marketing. Its marketing provisions were concerned principally with limiting the operations of TPC rather than the operations of the groups. TPC had the exclusive right to market oil in Iraq (sufficient for local needs), but it could not be interested, directly or indirectly, in the marketing of oil in any other area except to fulfill an obligation under a concession agreement.[87] Marketing outside of Iraq was, therefore, left free for the groups, and TPC was not to compete with the marketing organizations of the owners of TPC.

From the above analysis of restrictive provisions, it will be seen that the red-line agreement went a long way toward granting TPC an exclusive monopoly of the oil concession and production rights in Iraq; it eliminated competition between the owners of TPC for concessions in a much larger area; and in effect, it closed the "open door."

One oil company official has called the red-line agreement "one of the outstanding instances of international sharing and cooperation."[88] The agreement has also been described as "an outstanding example of a restrictive combination for the control of a large portion of the world's oil supply by a group of companies which together dominate the world market for this commodity."[89] However characterized, it did not carry out the oil policy for Mesopotamia which had been vigorously advocated by the American oil companies and the State Department in 1922.

OPERATIONS WITHIN THE RED-LINE AREA, 1922–39

The signing of the red-line agreement in July 1928 admitted the American group as an active participant in TPC's operations. Although this agreement was the culmination of 6 years of negotiations, it did not end the differences between the various owners of TPC. In 1927, oil had been discovered in substantial quantities. Hence, the partners were now confronted with two questions:

[85] Art. 16 (i) of group agreement of July 31, 1928.
[86] Art. 16 (ii) and 16 (iii) of group agreement of July 31, 1928.
[87] Art. 17 of the group agreement of July 31, 1928.
[88] From a memorandum titled, "The Participation of an American Group of Companies in the Development of Oil Through the Iraq Petroleum Co., Ltd.," prepared by C. S. Morgan, February 25, 1944.
[89] R. F. Mikesell and H. B. Chenery, Arabian Oil, University of North Carolina Press, Chapel Hill, N. C. (1949), p. 45.

How rapidly should TPC develop the Iraq concession, and how far should they go in closing the "open door"?

The Iraq concession of March 24, 1931.—As noted heretofore, the "open door" had been virtually closed in 1925. Of the original "open door" plan proposed by the American group, the only part which remained that could be of any practical value was the proviso in the Iraq concession agreement permitting parties, not members of TPC, to bid for leases on plots selected by the Iraq Government, i. e., the "outside areas." But no plots were even submitted for competitive bidding, and within a few years after the red-line agreement was signed, the "open door" seemed to have been finally closed.

Under the Iraq concession agreement of March 14, 1925, it was necessary for TPC and the Iraq Government to make their selection of plots before any party seeking a concession under the "open door" plan could tender bids. TPC was required to make its selection of 24 plots of 8 square miles each for its exclusive exploitation within 32 months from the date of the concession, and the Iraq Government was given 4 years in which to select the 24 plots to be offered for competition by sealed bids. Thus, TPC was to have made its selection by November 14, 1927, while the Iraq Government had until March 14, 1929, to make its selection.

Instead of selecting its plots, as the concession agreement provided, TPC asked for more time. In August 1927 the Iraq Government agreed to grant TPC, as well as itself, a 1-year extension of the time limit for the selection of plots.[90] But no selections were forthcoming since negotiations between the groups and TPC were still in progress. In April or May 1928 TPC began to negotiate with the Iraq Government for a 5-year extension of the time limitation. The King of Iraq agreed to the extension but, because of a new competitive development, was reluctant to place it before the Iraq Parliament for approval. This new factor was an independent British-Italian syndicate, the British Oil Development Syndicate (BOD),[91] which had indicated to the King that it was interested in obtaining oil leases on the "outside areas" to be selected for subleasing under the Iraq concession. Thus, the King had a bargaining point with TPC, and of course, the BOD Syndicate endeavored to induce the King to withhold the presentation of the extension agreement to the Iraq Parliament.[92] BOD's greatest bargaining power was derived from its offer to construct a transdesert railway from Bagdad to the Mediterranean. In return, BOD desired to select 24 plots which, if approved by TPC, the Iraq Government would then put up for bid under the "open door" plan.[93] Under this procedure, BOD hoped to purchase the plots and gain access to Iraq oil.

As a countermove, TPC agreed "to accept the principle of assisting in the guarantee of a railway in return for additional concessions

[90] From memorandum attached to letter from C. S. Morgan to W. C. Teagle, August 17, 1927.

[91] The BOD Syndicate was controlled by British and Italian interests. An Italian group had, shortly before the BOD episode, been denied an interest in TPC, so they apparently joined with some British friends to obtain an interest in Iraq oil outside of TPC.

[92] In a letter from Montague Piesse to Guy Wellman dated May 10, 1928, there appears the following:

"I can quite see that Lord Inverforth's syndicate, if it is really serious, will do all it possibly can to prevent any extension of time within which the TPC is to select its 24 plots, as this would, no doubt, have the effect of extending the time for the outside areas to be offered for competition, for the Government could not offer any outside areas until the TPC had made its selection of its 24 plots. I am thinking that the syndicate is waiting for these outside areas to be offered for tender and it would, therefore, not suit them to have the time extended for 5 years before any outside areas are offered."

[93] Telegram from Sir Adam Ritchie, general manager of TPC, Bagdad, July 4, 1928, to the directors of TPC.

and/or modifications in existing concessions." [94] The Iraq Government rejected several proposals which TPC placed before it and finally informed TPC that it must have a definite guaranty for the railway before the agreement for the time extension would be placed before the Iraq Parliament. In view of the offer received from BOD, the Iraq Government was of the opinion that it had to have some offer from TPC regarding the railway in order even to reject BOD's proposal.[95] TPC then offered to make a survey for the pipeline and railway to the Mediterranean in return for a time extension of 2 years, with a further proviso that if a new concession agreement were made, a further 5-year extension would be made.[96]

Although TPC continued to be interested in obtaining an extension of time within which to make its selection of plots, by the middle of 1928, officials closely connected with TPC were beginning to intimate that the Iraq concession agreement should be modified to bring the "outside areas" under TPC's control and thereby eliminate the auction plan, i. e., what was left of the "open door." [97]

In April 1929 Sir John Cadman, chairman of TPC and formerly with the Anglo-Persian Oil Co., in reporting on a visit which he had made to Iraq, lauded the prospects for oil development there, but also indicated his concern over the limitations on the total number of plots which could be taken up by TPC. He stated:

> I must frankly state, however, that the predominant consideration in my mind—and one which grows steadily in importance the more I reflect the future of the company—*is the inadequacy of the aggregate area to be definitely conceded to the company*. * * * when regard is had to the formidable character of the financial commitments immediately resulting from the selection.[98] [Italics added.]

Sir John went on to suggest to the TPC board that it should make a complete review of the problems of whether the Iraq Government should not be approached on the whole subject of the concession area, the auction system, and other related questions.[99] When in June 1929 TPC [1] was informed that the Iraq Government would be pleased to discuss a modification of the agreement,[2] negotiations with the Iraq Government were expanded to include a complete revision of the 1928 agreement, and IPC prepared to make a more or less tentative selection of its 24 plots in order to comply with the old agreement

[94] Cable from Montague Piesse to Stuart Morgan, July 17, 1928.

[95] The BOD offer to construct a railway was rejected by the Iraq Government because the road would not extend beyond the western boundary of Iraq. See cable from Sir Adam Ritchie to TPC, July 11, 1928.

[96] Minutes of meeting of directors of TPC, July 31, 1928. Although BOD was unsuccessful in its efforts to secure a foothold in Iraq at this time, it secured a concession in 1932 in other parts of Iraq which were not included in the TPC concession area. (See p. 212.)

[97] On July 13, 1928, before the group agreement was signed, Montague Piesse wrote to Stuart Morgan, director of Near East Development Corp., as follows:

"*I see very plainly what is in the minds of the board of the TP Co.* when they talk of acquiring additional concessions and/or modifications in the existing concession. In return for any help or assistance that the TP Co. may be prepared to give to the Iraq Government in connection with the financing of the trans-desert railway, *they want to ask the Iraq Government to modify the concession by withdrawing the obligation to auction the outside areas, so that these areas may be included* definitely in the Iraq concession." [Italics added.]

[98] Note by Sir John Cadman regarding visit to Iraq, April 1929.

[99] Ibid.

[1] The TPC changed its name on June 8, 1929, to the Iraq Petroleum Co., Ltd., and hereafter will be known as IPC.

[2] Montague Piesse, in reporting to Stuart Morgan on July 30, 1929, regarding a meeting of the IPC board, stated that the board had discussed the status of the negotiations with the Iraq Government, which were being conducted at Bagdad by Mr. Bull representing IPC. Mr. Piesse quoted Mr. Bull as having said that "* * * he had been in consultation just before he left Bagdad with the Prime Minister and other members of the Cabinet, who had expressed themselves as *being entirely in favor of giving the IPC all they required because Iraq was, in fact, looking to the company to develop its petroleum resources.* * * * Mr. Bull stated that if the IPC desired to have the concession, particularly articles 5 and 6, altered or modified in any way, the Iraq Government would be very pleased indeed to discuss with the IPC any views they had in this connection." [Italics added.]

and eliminate from the area of discussion the question of an extension of time.

Although, because of differences between the owners of IPC,[3] the negotiations were subject to many delays, a new agreement was finally signed by IPC and the Iraq Government on March 24, 1931, under which IPC was freed from all provisions referring to an "open door" plan. Instead of having a concession of 192 square miles, IPC now had a concession comprising all lands situated in the vilayets of Bagdad and Mosul east of the Tigris River, comprising approximately 32,000 square miles as compared with 192 square miles under the previous agreement. All provisions referring to subleasing and auctioning of plots were deleted from the agreement, and IPC was also relieved of all drilling obligations, present or future, and was given a completely free hand in developing the concession.[4]

In return for the concession, IPC was to construct a pipeline with a capacity of not less than 3 million tons of oil a year. The line was to be constructed "with due diligence" and to be completed not later than December 31, 1935. IPC was to pay the Iraq Government an annual royalty of not less than £400,000 gold, one-half of which was to be recoverable by the company in subsequent years by deductions from the fixed royalty. IPC was also given permission to construct and operate such railways as were necessary for the purpose of constructing the pipeline but was not bound to build a railway. Finally, the Iraq Government was to be supplied by the company with petroleum products at base prices which were specified in the agreement. These base prices were to vary in accordance with world market prices, and were varied annually in accordance with changes in export prices at the United States Gulf.

Contemporary records show that the American group did not vigorously defend the "open door" but acquiesced in closing it. One official stated that—

> * * * so far as the Near East and the members of the American group are concerned, their position must, I feel, always be consistently maintained for the operation of the open-door plan as proposed through the offering of outside areas.[5]

But he went on to say:

> Considering the position of the Turkish Petroleum Co. * * * and also considering the position of the Government of Iraq * * * it is quite possible to understand that the business aspects of their respective problems might very well lead to a decision to eliminate the provision for offering outside areas and to treat the so-called outside areas as a definite part of the territory leased to the exclusive operation of the Turkish Petroleum Co.[6]

This rationalization for a new agreement which would eliminate the "open door" provision was later followed by a stronger statement by W. C. Teagle of Standard Oil Co. (N. J.), who stated:

> * * * it is our feeling that the desired modification in the concession should, if at all possible, be secured before November, when, under the present convention, the Iraq Government can ask the company to start putting up tracts for auction.[7]

[3] These differences were over matters which were not directly related to the concession agreement, such as direction of pipeline and delays in development in Iraq. The problems are discussed in a subsequent section.
[4] Iraq Petroleum Co., Ltd., agreement concluded on March 24, 1931, with the Iraq Government.
[5] Letter from Guy Wellman to Montague Piesse, July 26, 1928.
[6] Ibid.
[7] Letter from W. C. Teagle to Horace Finaly, Paris, September 8, 1930.

The following appears in the May 28, 1931, minutes of meeting of the IPC directors:

> Mr. Seidel communicated to the board a resolution dated 13th May passed by the board of the Near East Development Corp. expressing their full approval of the new agreements.[8]

Inasmuch as Mr. Seidel was the Near East Development Corp.'s director on the IPC board, this would appear to indicate that the American group approved the new agreement.

Effect of restrictive provisions of the 1928 group agreement.—The various provisions in the group agreement designed to limit the individual freedom of action of the partners in IPC have been noted in previous sections. Attention will now be directed to the effects and applications of these restrictive provisions in specific areas.

Gulf Oil Corp.'s option on Bahrein.—On December 2, 1925, the Eastern and General Syndicate (a British firm headed by Maj. Frank Holmes), acquired from the Sheik of Bahrein an oil concession over an area of about 100,000 acres, with the exclusive right to develop the area. Shortly thereafter, the concession was extended to include all of the island of Bahrein and the islands adjacent thereto under the jurisdiction of the Sheik of Bahrein. Subsequently, on November 30, 1927, Eastern Gulf Oil Co., a subsidiary of Gulf Oil Corp., entered into an option contract to purchase Eastern and General Syndicate's concession rights in Bahrein. Gulf was given until January 1, 1929, to exercise its option.[9]

In May 1928, before the American group had signed the group agreement, Gulf confidentially advised the other members of the American group of the option contract with the Eastern and General Syndicate, but the American group held the matter in abeyance until they became members of TPC under the group agreement.[10] As one of the American signatories, Gulf was bound by its restrictive provisions.

In October 1928, the proposal was presented to the board of directors of TPC. Gulf had not decided whether or not it desired to exercise its option but wanted clarification from the TPC board before pursuing the matter further. The specific question before the board was whether Gulf's contract came within the provisions of article 10 of the red-line agreement.[11] Under article 10, it was possible for the TPC board to make one of three rulings: (1) it could decide that Bahrein was not within the defined area, as indicated by the map in the red-line agreement, and thus permit Gulf to act independently with respect to its option; (2) it could rule that Behrein was within the red-line agreement and transfer Gulf's rights under the option contract to itself (TPC); or (3) it could rule that Bahrein was within

[8] Minutes of meeting of directors of IPC, May 28, 1931.

[9] From Abstract of Option Contract, October 3, 1928, and from Analysis of Bahrein Concession, attachments to letter from H. L. Stone of Gulf and Guy Wellman (SONJ) to Montague Piesse, London, October 3, 1928. The above letter with the attachments were presented to the directors of TPC on October 26, 1928, with a request that Gulf's option be reviewed.

[10] In a letter from Guy Wellman to H. G. Seidel, Paris, May 16, 1928, Mr. Wellman notified Mr. Seidel of the existence of Gulf's relations with Eastern and General Syndicate. Mr. Wellman also went on to express his views regarding what would happen under the "self-denying" clause of the group agreement in the event it was signed by the American group. He wrote as follows: "This Gulf contract, however, will not be allowed to reach the point of embarrassment to the American group in relation to the other groups and the TP Co. The Gulf's action is in abeyance at our request until the participation of the American group is concluded * * *. This matter will probably straighten out in due season either by surrender of the open door or an offer to turn it over to the TP Co. under art. 10 of the proposed group agreement, if that is possible under the terms of the option, or by a new agreement with the syndicate."

[11] Art. 10 of the group agreement of July 31, 1928, was a section which bound the groups not to be interested, directly or indirectly, in any oil concessions within the defined area. The specific provisions of this article have heretofore been discussed.

the red line agreement and refuse to take over Gulf's option contract. In its presentation to the board, Gulf indicated that if it were covered by article 10 of the group agreement it would endeavor to get the option transferred to TPC. But the TPC board ruled that it would not accept the offer of the option and that if Gulf should decide to develop the concessions it would be bound by the terms of the group agreement.[12] In effect, this meant that, if Gulf exercised its option, any oil that it developed in Bahrein would have to be shared with TPC. Furthermore, by its ruling, the TPC board indicated that it did not want to assume any of Gulf's obligations under the option agreement.

Contractually speaking, Gulf was effectively precluded from further activity in Bahrein. On December 21, 1928, it transferred the Bahrein option contract to the Standard Oil Co. of California, thus providing the first illustration of the use of the group agreement to limit independent action by companies participating in IPC operations.

Negotiations regarding Standard Oil Co. of California's Bahrein and Saudi Arabian concessions.—The restrictions on individual activity in the red-line agreement also hampered and embarrassed the participants in dealing with the important discoveries of oil during the 1930's by the Standard Oil Co. of California in its concessions in Bahrein Island and Saudi Arabia. These important additions to known Middle East oil resources promised to disturb existing Middle East oil relationships and to upset market arrangements and unstabilize prices in Europe and the Far East. Alarmed by these discoveries, the three major groups—Anglo-Iranian, Shell, and NEDC—attempted to bring these fresh supplies of oil under some form of control. Their efforts, however, were enormously complicated by the restrictions in the red-line agreement itself, since CFP and Gulbenkian were determined to safeguard their own interests in any arrangement that could be made with Standard of California. The resulting negotiations among the group members of TPC and between them and Standard of California were extremely tedious and reached no definite conclusion up to the outbreak of World War II in 1939.[13]

It is interesting to note that, had the individual members been able to operate freely and independently, it is possible that a partnership arrangement would have been effected with Standard Oil Co. of California before World War II. The fundamental reason for the provisions in the red-line agreement restricting the individual activities of the participants was to prevent the groups in IPC from competing with each other. But when the IPC groups were confronted with outside competition which they wished to neutralize, they found themselves almost completely shackled by the provisions which they had originally approved for their own mutual protection.

The discovery of oil in Bahrein alarms Anglo-Persian.—The Standard Oil Co. of California obtained Gulf's option contract to the Bahrein concession. In 1928 and thereupon it immediately took steps to

[12] Letter from E. J. Brown, secretary, Turkish Petroleum Co., Ltd., to Montague Piesse, London, November 12, 1928.

[13] Although World War II interrupted negotiations between the groups and prevented the formal signing of the agency and related agreements, the Big Three continued to be interested in reaching an understanding with Standard Oil Co. of California and the Texas Co. in respect to their Middle East concessions. Evidence of this is the fact that after the war the joint owners of NEDC (Standard Oil Co. (New Jersey) and Socony-Vacuum), succeeded in obtaining a 40-percent interest in the Saudi Arabian concession. Events after the war are discussed in subsequent sections of this chapter.

exercise the option.[14] By early 1930 negotiations were completed. Standard of California then organized the Bahrein Petroleum Co., Ltd., to hold the Bahrein concession, and exploration work began immediately. Oil was discovered in 1932, and rapid development followed.

The IPC, and particularly Anglo-Persian,[15] regarded the discovery of oil in Bahrein as a distinct threat to their interests. Previously, Anglo-Persian had controlled the only important source of crude oil in the Persian Gulf. In fact, outside of IPC, Anglo-Persian's Iran concession had been the only important source of crude in the Middle East. Moreover, Bahrein crude was low-cost crude: the discovery well came in under its own pressure at 2,008 feet with a potential output of several thousand barrels per day; and only 12 miles of pipeline were required to get the crude to a tanker-loading terminal on the Persian Gulf.[16] Thus Bahrein was a more direct threat to Anglo-Persian than to any of the other IPC groups. The chairman of IPC (formerly with Anglo-Persian) lost no time in discussing the Bahrein problem with the president of Standard Oil Co. of California, but apparently without any positive results.[17]

As a countermove, Anglo-Persian tried to obtain some 70,000 acres in Bahrein which was not included in the concession held by Standard of California. In 1933, Sir William Fraser, of Anglo-Persian, suggested at a meeting of the IPC groups that a concession on parts of Bahrein was of potential interest, and directed attention to the danger which the groups ran of losing concessions by the delay involved in having every step discussed by the groups before any action would be taken. He suggested that Anglo-Persian be permitted to conclude negotiations for the areas still available in Bahrein on the understanding that if none of the groups were willing to participate Anglo-Persian should be permitted to take up the concession by itself.[18] Although NEDC opposed the suggestion,[19] Anglo-Persian was eventually permitted to negotiate for a concession in Bahrein provided (*a*) that the terms of the offer had the concurrence of one other group, in this case Anglo-Saxon (Shell), and (*b*) that if the concession were obtained participation would be offered to the other groups in accordance with the group agreement. If Anglo-Persian could not obtain the concur-

[14] Bahrein is an island in the Persian Gulf, adjacent to Saudi Arabia, and was ruled by a sheik under British protection. Because of British influence the Bahrein concession had to be approved by the British Government. The United States Department of State intervened and assisted Standard of California in obtaining the concession in Bahrein. See American Petroleum Interests in Foreign Countries, op. cit., p. 318.

[15] G. S. Walden, SONJ representative on the IPC board, in a memorandum to H. G. Seidel, dated September 15, 1932, stated: "There is no doubt that the Standard Oil Co. of California's well is giving real concern to the Anglo-Persian."

[16] The Petroleum Times, October 30, 1937, p. 584.

[17] In a letter from M. Piesse to Stuart Morgan, dated December 23, 1932, M. Piesse reported on the actions taken and the discussions that had occurred at IPC board meetings. He stated that Sir John Cadman, chairman of IPC, had just returned from the United States. Sir John is quoted as follows:

"The chairman advised the Board that whilst in the United States he had met Mr. R. K. Kingsbury, president of the Standard Oil Co. of California, and that he had had some discussions with him in regard to this concession and that Mr. Kingsbury would be in Europe in the new year when the chairman was to have some further discussions on this subject."

In this connection it is interesting to note that one Standard Oil Co. (New Jersey), representative on the IPC board thought that "this production in the hands of the Standard Oil Co. of California might be more of a menace to the Anglo-Persian Oil Co., Ltd., than perhaps to the IPC."

[18] Minutes of meeting of group representatives, July 10, 1933.

[19] Ibid. Mr. Seidel, the NEDC representative on the IPC board, objected to Mr. Fraser's proposal, pointing out that it was contrary to the provisions of the red-line agreement, that these provisions had been strictly enforced against the Gulf Oil Corp. when Gulf had offered its option on the Eastern and General Syndicate's Bahrein concession to TPC in 1928, and that it would be unlikely that NEDC would agree to waive the provisions of the agreement in favor of the Anglo-Persian in the present instance. Mr. Seidel was Standard Oil Co.'s (New Jersey) representative on the IPC board, and this strong position would indicate that NEDC (including Standard Oil Co. (New Jersey)) did not fear Standard Oil Co. of California as much as it did Anglo-Persian.

rence of Anglo-Saxon before it concluded the deal, Anglo-Persian would then have to secure the consent of one of the other groups.[20]

Despite the pressure from the British representative in IPC, Anglo-Persian was never able to obtain an interest in Bahrein, and Standard of California's concession was extended in 1940 to cover the entire island of Bahrein.[21] Had the red-line agreement not prevented Anglo-Persian from negotiating independently of the other IPC members, it is possible that Anglo-Persian would have secured a concession in Bahrein and perhaps sought an agreement with Standard of California.

Standard Oil Co. of California and IPC compete for Saudi Arabia but IPC withdraws.—The discovery of oil in Bahrein stimulated interest in the entire mainland of Arabia as a potential source of oil. IPC and Standard Oil Co. of California were soon actively competing for a concession in Saudi Arabia.

There was talk of IPC forming a partnership with Standard of California, but some groups thought this would give the American companies too large a share in IPC.[22] Although IPC was interested in obtaining the concession, it appears that the terms asked by the Saudi Arabian Government were not acceptable.[23] On May 5, 1933, the directors of IPC "decided that it was not desirable that the IPC should apply for an oil concession over El Hasa.[24]"

Regardless of IPC's decision, Anglo-Persian continued its effort to obtain a concession in Saudi Arabia. As has been noted, under the red-line agreement it was necessary for Anglo-Persian to get one of the other major groups in IPC to join with it in applying for the concession.[25] Hence, in order to conform to the agreement, Anglo-Persian, on May 6, 1933, invited the American group to join in the venture.[26] It is not known whether the American group favored such a plan, but in any event the attempt failed. On May 29, 1933, Standard Oil Co. of California was granted a concession in the El Hasa area in eastern Saudi Arabia, covering about 56,000 square miles.[27]

The Big Three attempt to reduce the red-line area.—With Standard of California now holding concessions in Saudi Arabia as well as in Bahrein, the Big Three (Anglo-Persian, Shell, and NEDC) were faced with a large potential competitor at their back door who was not a participant in their world-wide plan to stabilize crude oil production.[28]

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[20] Ibid.

[21] See Mikesell and Chenery, op. cit., p. 50.

[22] G. S. Walden said in a letter to Guy Wellman, dated April 11, 1933:

"During the discussions the question was raised whether the IP Co. would be willing to go into a partnership with the California company in Hasa, and while there was no voice of objection there were statements that such a pooling of interests would result in excessive American representation. On the other hand, I personally do not believe that there would be any great objection from any of the groups if the California company wanted to turn in all of their interests in this part of the world in return for a participation in the IPC."

[23] Letter from J. Skliros, general manager of IPC, to the members of the outside concessions committee of IPC, March 20, 1933, and minutes of meeting of directors of IPC, May 5, 1933.

[24] Minutes of meeting of directors of IPC, May 5, 1933. El Hasa was the area in Saudi Arabia being sought by Standard Oil Co. of California.

[25] Clause 10 of the agreement provided that if IPC refused to apply for a concession, but two groups agreed to apply, then IPC was bound to grant permission to a nominee of these groups to go ahead and seek the concession, but if successful, each of the other groups in IPC would be entitled to be offered their participating share.

[26] Cable from M. Piesse to Near East Development Corp., May 6, 1933. Gulf was at this time still a member of the American group and Gulf's representative was in favor of joining with Anglo-Persian in obtaining the Saudi-Arabian concession.

[27] Note by S. H. Longrigg, IPC negotiator, May 12, 1936, appended to letter from J. Skliros to the directors of Petroleum Concessions, Ltd., May 13, 1936.

[28] See ch. VIII for a discussion of this plan.

Confronted with a fait accompli, their next move was to try to reduce the area covered by the red line, thereby enlarging the area for which the members could negotiate independently. In 1934 Shell, Anglo-Persian, and the American group made several unsuccessful attempts to induce the French and Gulbenkian to agree to alter the red-line agreement, so as to exclude Bahrein and Arabia from the red-line area. This would have given the three groups a free hand to negotiate an agreement with Standard of California for a share in the Bahrein and Arabian concessions without having to give the French and Gulbenkian their proportionate share, as required by the red-line agreement.[29]

But the French and Gulbenkian would not agree to any such proposal. It appears that the Big Three asked too much, and thus led the French to believe that an attempt was being made to eliminate them from a very large area covered by the red-line agreement.[30]

Attempts to work out a compromise with the French and Gulbenkian.—Failing in their first attempt to obtain a realinement of the Red Line, the Big Three next attempted to work out a compromise with the French and Gulbenkian which would permit them (*a*) to acquire the Bahrein and Arabian concessions, or (*b*) to eliminate these concessions from the red-line area, or (*c*) to purchase the petroleum produced from these concessions. On July 9, 1934, NEDC (the American group), with the support of D'Arcy Exploration Co. (Anglo-Persian), was empowered by the IPC groups to negotiate and close an agreement with Standard Oil Co. of California for the acquisition of its concessions in Bahrein and El Hasa "and/or the purchase of any production of oil from these concessions or to effect with that company such other exploitation understanding as may be advisable."[31] In the event an arrangement was made with Standard of California, participation was to be offered to the other groups on the basis of their basic proportions as provided under the red-line agreement, with the qualification that CFP (the French) and Participations & Investments, Ltd. (Gulbenkian) would not participate in the first 400,000 tons of production obtained from these concessions. In addition it was agreed that if the French decided to participate and wanted to market this oil, its marketing activities would be restricted. CFP would be bound to offer their share of this additional oil to the other three major groups until such time as CFP were able to develop an eastern market which would presumably be large enough to absorb the oil acquired from the Standard of California concessions.[32]

[29] A cable from H. G. Seidel to W. C. Teagle, July 10, 1934, stated: "President of Amiran proposed revision of alinement of red line finally unsuccessful * * *." Letter from H. G. Seidel to Guy Wellman, July 10, 1935 also showed that Shell had attempted to negotiate a change in the red-line restrictions.

[30] In a letter written May 8, 1935, J. Skliros, general manager of IPC, related some of the problems of the discussions with the French with respect to changes in the red-line agreement. He wrote as follows:

"That matter was discussed last year for a fortnight on end, and ended in smoke—all because of bad tactics. I had tentatively sounded the French about putting Bahrein and possibly Hasa, outside the bounds of the red line and they told me they would have no strong objection, if the groups acted nicely. But the groups understand continental psychology far better than I do, and in order to obtain Bahrein they asked the French to revise the red line, leaving out all the territory to the south of a line drawn from Suez to Bagdad. And the French were astounded. One group claimed experience at negotiating with orientals and said if you want an inch you must start off by asking for a yard. The French were offered successive lines, from Bagdad to the Red Sea, to halfway down the Red Sea to Aden, etc. But the French would not play the game l'orientale, dug in their toes, and refused to give up an inch. I generally lunch with them after these meetings and they told me they felt very humiliated in being treated like bazaar merchants; that if they had been asked fair and square to surrender Bahrein, they would have agreed, and might even had let Hasa go, but Suez to Bagdad was the result, and with that crowd, if your tactics are not right from the start, it is very difficult to retrieve your position." Quoted from a memorandum written by Guy Wellman to W. C. Teagle and William S. Farish, dated May 22, 1935.

[31] From minutes of group meeting, July 9, 1934.

[32] Ibid.

NEDC opened negotiations with the French by pointing out that adherence to the red line resulted in unfortunate repercussion for some of the groups—

> * * * in that as long as California would not sell and were not in a position to trade with any of the Iraq partners now interested in selling products in the Far East, they would be obliged to become competitive and in forcing an entry into these markets, would adversely affect the price structure in those markets.[33]

In these circumstances NEDC hoped, as did Shell, that the French—

> * * * could see their way clear to remove the Red Line from the concessions now held by the California company.[34]

The French, however, were concerned about the price at which crude oil was being delivered to them under the red-line agreement and attempted to use the price question as a bargaining point.[35] Basically, the difference between the parties was that Shell, Anglo-Persian, and NEDC wanted a high price for IPC crude, which meant that they could amortize expenses and earn a return on capital with a relatively smaller output, while the French were interested in a low price for oil and a long period for depreciating and amortizing expenses, which would have the effect of inducing a larger production from IPC in order to cover expenses and a return on investment. The three major groups were also afraid that if Iraq crude were delivered at a low price the French might use the low price for Iraq oil as a means of influencing product prices in France.

Although recognizing that a satisfactory solution to the price question would be difficult, NEDC (the American group) was glad to have this opportunity to negotiate for the Standard of California concession.[36] Wishing to make the most of this opportunity, NEDC, as a conciliatory act, agreed to do what it could about the price question if the French, in return, could see their way clear to alleviate the red-line problem.[37]

The next problem was to get NEDC, Shell, and Anglo-Persian to agree among themselves on the price question and on the changes that

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[33] Letter from H. G. Seidel to Guy Wellman, July 19, 1935.

[34] Ibid.

[35] In a letter from H. G. Seidel to W. C. Teagle, July 10, 1934, the points at issue are described as follows:

"*We have had almost continuous meetings for the past 2 weeks in order to try to settle the important questions of the California company concessions within the red line and the price at which Iraq oil could be made available for the groups. Although these 2 questions were considered as independent of each other, it was quite obvious that the price question was used as a lever to bring about the revision of the red line.*" [Italics added.]

Shell, Anglo-Persian, and the NEDC maintained that IPC should deliver oil to the groups at a price which would cover expenses such as royalties, exploration expenses, and depreciation of fixed assets, and that these expenses should be written off as rapidly as possible. The French, on the other hand, contended that the price should cover only a reasonable allowance for depreciation and repayment of capital based upon a long period of depreciation and amortization. It was the French view that this procedure was the one required under the group agreement.

In a letter from H. G. Seidel to Stuart Morgan, July 10, 1934, there appears the following:

"We have had in mind the previous agreement of the Near East Development Corp. to the United Kingdom income tax basis, *and the primary reason for rejecting this basis in the present discussions was the possibility that the French Government might use this price as a basis for influencing product prices in France.*" [Italics added.]

[36] In reporting on the discussions with the French, H. G. Seidel in a letter to W. C. Teagle, July 10, 1935, reported that Colonel Mercier (CFP representative on IPC) had stated:

"* * * in a full meeting that if his group were outvoted on the price question and would have to pay an abnormally high price for their oil, that his position would become untenable and he would have to resign as chairman of the company, i. e., Compagnie Francaise des Petroles. *He went on further to say that in all probability his Government would be provoked to retaliation and that the monopoly question would be reopened as a result.*

"*This statement by Colonel Merceri seemed to satisfy the Shell group that it would be impossible to carry through the realinement of the red line as they had hoped,* and a constructive effort was made when the situation become precarious. *As a result, we have secured the agreement of the other groups in the Iraq Petroleum Co. that the Near East Development Corp. should negotiate for the Standard Oil Co. of California concessions in Bahrein and Arabia under the provisions of the working agreement.*" [Italics added.]

[37] Letter from H. G. Seidel to Guy Wellman, July 19, 1935. The French were of the opinion that they could remove the red line from Bahrein Island but they, as well as NEDC, believed it would be difficult to remove the red line from Standard of California's Arabian concession, which was found to be larger than the State of California.

should be made in the red-line agreement, so that a joint proposal on these matters could be made to the French. Shell was insistent that they should try to remove the French from Arabia entirely, change the red line to run from Basrah to Suez, and compensate the French for any loss of oil by replacing barrel for barrel on the Mediterranean any oil produced by the groups east of the red line.[38] NEDC contended, however, that the French would not accept such a proposal. After a lengthy discussion the Big Three agreed to propose merely that the red line should be redrawn so as to exclude the concessions held by the Standard Oil Co. of California in Bahrein and Arabia.[39] Also, to assure action through the IPC itself, it was agreed that as among the Big Three, the provisions of the red-line agreement restricting individual action would still apply to the Standard Oil Co. of California concessions. In short, the proposal agreed upon was to exclude these concessions from the red-line area so that the Big Three would be free to negotiate with Standard of California while retaining the restrictions on individual section by the Big Three.[40] Anglo-Persian and Shell also agreed to a solution of the price question, which was necessary if the groups were to get the French to support changes in the red line.[41]

Like the previous proposal, this attempted compromise also foundered on the rocks of French resistance, principally because the Big Three would not accede to the price terms demanded by the French.[42] Moreover, Gulbenkian entered the negotiations with demands to preserve his interests in the red-line area in the event a deal was made with Standard of California.[43] The Big Three negotiated for some time with the French and Gulbenkian in an attempt to work out a solution, but no satisfactory arrangement could be devised. The French continued to insist upon a revision of the method used to price IPC crude. They also resented the group's attempt to exclude such a large area from the red-line agreement, thereby preventing France from participating in oil produced in the excluded areas. To compound the delays, Shell, NEDC, and Anglo-Persian, were making

[38] Ibid.

[39] A Draft of Minute, which was to be discussed at IPC board meeting, was enclosed with above letter from Seidel to Wellman. This draft was not formally approved by IPC board but it indicates intentions of the three groups. The draft read:

"As the present concessions held by the Standard Oil Co. of California on the island of Bahrein and on the mainland of Arabia and El Hasa come within the restrictions of the red-line demarkation mentioned in the group agreement of July 31, 1928, without benefit to any of the present group members but resulting in a detrimental effect to some of these group members, it is agreed, without such action establishing a precedent, that the red line shall be redrawn so as to exclude all present concessions held by the Standard Oil Co. of California in the above areas."

[40] Guy Wellman received letter from H. G. Seidel, written on July 19, 1935, which stated as follows:

"* * * it became evident that the Shell group were coupling the removal of the red line from the California concessions with a general agreement with the California company, the onus of which should be borne by Standard-Vacuum or one of the Standard groups. At the end, when no solution seemed possible, *Fraser suggested that we accept the proposal which had been made in the beginning with the condition that the self-denying ordinance would continue to apply on these California concessions as between the Shell, Anglo-Persian, and NEDC. This I accepted and they in turn were agreeable to a solution of the price formula*" [Italics added.].

[41] Ibid. Draft of Minute No. 2, Price of Oil, was enclosed with above letter from Seidel to Wellman. This minute was formally approved at a group meeting on July 18, 1935, and read as follows:

"It was resolved unanimously that the price at which the oil should be offered to the groups should be fixed by the board annually for the ensuing year at a figure which would represent as nearly as possible the cost as allowable for United Kingdom income tax as estimated by the management, plus 1 shilling per ton." Although approved by the groups, they did not put this pricing method into operation immediately, and hence this remained a subject of negotiation with the French.

[42] Letter from H. G. Seidel to W. C. Teagle, October 30, 1935.

[43] Cables from H. G. Seidel to W. C. Teagle, dated November 20, 1935, December 4, 1935, and December 6, 1935.

little progress in their discussions in New York with Standard of California.[44]

Big Three forced to meet demands of French and Gulbenkian on price question.—By the end of 1935, the French (CFP) demands for a reduction in the price at which Iraq crude was sold to the groups could no longer be evaded. The French circulated a letter criticizing the groups for not putting into effect their so-called income tax price scheme which had been approved in July 1935.[45] They insisted the IPC decisions could no longer be delayed—

> * * * because negotiations with Standard Oil Co. of California have come to no conclusion.[46]

The reactions of NEDC officials were summarized as follows:

> * * * it is our feeling that since the negotiations with Socal in America have not progressed materially, and since the proposals negotiated with the French and Gulbenkian groups were not acceptable, that *before conceding the price basis as demanded by the French group, we should at least try to obtain the exclusion of Bahrein Island from any restrictions of the group agreement, at the same time securing, if possible, the continued agreement of the French and Gulbenkian groups to negotiate and eventually conclude an agreement with the California Company for the El Hasa concession in Arabia.* In view of the previous assurances given us by Colonel Mercier and the French group, we felt there was a reasonable chance for securing a settlement on this basis, and while this would not materially facilitate an agreement with the California Co., *at least it would have excluded a considerable potential production from the present restrictions, and to this end would be of help to the Standard-Vacuum Co., in the protection of its eastern markets.*[47]

Although hesitant to accept the price demands of the French, Shell subsequently concurred. In February 1936, a resolution was unanimously passed providing that the price of IPC oil to the groups should be fixed at a price which would represent the estimated United Kingdom income tax cost plus 1 shilling.[48] NEDC regretted the price concession, as it was their chief bargaining point with the French and Gulbenkian. One NEDC official wrote:

> * * * we have been jockeyed into the position of giving up our trump card for securing French group and Gulbenkian agreement for any early settlement of the Bahrein-El Hasa question. Although I emphasized to the French group that in view of the settlement of these questions we would look to them for their friendly assistance in the solution of the Bahrein-El Hasa problem, the fact remains that today's meeting has not improved our position for negotiating this question.[49]

Big Three permitted to continue negotiations with Standard of California but Gulbenkian blocks a group arrangement.—As partial compensation for comprising on the price question, the French and

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[44] In fact, it appears that the IPC groups were now trying to negotiate an agreement for purchasing Standard of California's crude rather than forming a partnership or taking over these concessions.

The Petroleum Times of November 30, 1935, stated:

"Following the abortive disappointing results of the New York conference on the question of purchase of Bahrein and Eastern Saudi Arabian crude by several of the major companies, the Bahrein Petroleum Co. is proceeding actively with its plans for the construction of its new 10,000 barrel refinery on Bahrein Island * * *"

There were also indications that the groups might have to purchase or shut-back Standard of California's production in Bahrein (no oil had yet been discovered in Saudi Arabia) during the period of negotiation. H. G. Seidel wrote W. C. Teagle on July 10, 1934:

"If, during the interval of the negotiations it will be necessary to give California company relief, it is urged that the price for Bahrein oil be made as low as possible since an off-take of this oil can only be secured at considerable relative sacrifice on the part of all the groups. Under these conditions, it may be preferable to pay a premium to shut-back this production during negotiations providing this could be arranged on a satisfactory basis."

[45] Letter from E. Mercier to Sir John Cadman, chairman of IPC, January 13, 1936. The income tax price scheme has been previously described. See footnote 1, p. 191.

[46] Ibid.

[47] Letter from H. G. Seidel to W. C. Teagle, February 10, 1936. [Italic added.]

[48] Ibid. Also minute of group meeting held February 10, 1936.

[49] Letter from Seidel to W. C. Teagle, op. cit.

Gulbenkian agreed to permit the Big Three to conduct further negotiations with Standard of California.[50] But freedom to negotiate was only the first step, for the groups first had to agree among themselves regarding the alterations they were willing to make in the red-line agreement before any effective arrangement could be worked out with an outside company.

By May 7, 1937, the groups reached an understanding among themselves.[51] They agreed to depart from the red-line agreement so that some or all of them could, under specified conditions, purchase crude and refined products from Standard of California without being subjected to penalties and restrictions. This proposed arrangement permitted the groups to purchase refined products. It appears that up to the end of 1935, the groups had hopes of purchasing the Bahrein crude [52] but when it became clear that Standard of California and the IPC groups could not reach an understanding with respect to Bahrein crude, Standard of California began to plan for the construction of a refinery at Bahrein, and by 1937 this refinery was practically completed. Moreover, in 1936, Standard of California sold a one-half interest in its Bahrein and Saudi Arabian concessions to Texas Co., and in return received a one-half interest in Texas Co.'s, marketing facilities, which extended throughout the Far East. A new company, the California-Texas Co. (Caltex) was formed to conduct Bahrein's marketing operations. Thus, in 1937, Caltex was prepared not only to produce but also to refine and market.[53]

Under the proposed arrangement, the Big Three were conceding to the French (CFP) and Gulbenkian the right to take their proportionate share of any purchases made from Caltex. In addition, the French were granted permission to construct a refinery at the terminus of the pipeline.[54] There also were collateral provisions and supplementary arrangements which were included primarily to induce the French and Gulbenkian to agree to the Bahrein deal.[55]

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[50] The minutes adopted at a group meeting held on February 10, 1936, read:

"Regarding the Persian Gulf concessions of the Standard Oil Co. of California, Monsieru Mercier confirmed *that the three groups with eastern markets were free to continue negotiations with the Standard Oil Co. of California*, and if and when any arrangement were reached, the French group would use their best offices to remove any obstacles that were placed in the way of such an agreement by reason of the terms of the existing Group Agreement; so soon as some concrete proposal was put forward the French group would be prepared to approach again the French Government. Mr. Gulbenkian associated his group with the French group in this matter." [Italic added.]

[51] H. G. Seidel wrote Guy Wellman, February 17, 1938, as follows:

"*Since the discontinuance of our talks with the California company we have, if you will recall, tried to work out a Bahrein agreement. On May 7, 1937, we had reached agreement between all the groups essentially.* * * *". (Italic added).

Attached as annex I to Seidel's letter was a draft of the agreement. The main provision was as follows:

"It is agreed that *the limitations prescribed in clause 10 (i) of the group agreement of July 31, 1928*, on indirect interests in production or interests in the purchase of oil produced within the defined area *shall not be deemed to apply to arrangements with the Standard Oil Co. of California, the Texas Corporation and/or any company or companies affiliated or associated with them* and/or directly or indirectly controlled or managed by either or both of them (hereinafter called C-T) *in respect of crude oil or refined products not in excess of a quantity equivalent to the production from time to time of crude oil from the Bahrein Petroleum Co's concession in Bahrein.* (Italics added.)

[52] See p. 192, footnote 2.

[53] This may explain why, in May 1937, an official of Standard Oil Co. (New Jersey) was not anxious to negotiate a waiver of the red line until he could see clearly what the outcome of the negotiations with the Standard Oil Co. of California and the Texas Co. would be. It also gives substance to this official's understanding that in 1937 the California-Texas Co. did not expect to have any surplus of Bahrein crude, that they were not interested in making a commitment as to the disposition of any crude that might be discovered in Arabia, and that they had developed a definite plan for entering the Indian market. In those circumstances the Standard Oil Co. (New Jersey) official did not think it desirable to waive the red line against members of IPC purchasing crude from outsiders, and suggexted that the IPC groups should try to eliminate Bahrein from the red line and then offer Standard of California and the Texas Co. a share in IPC in return for their Saudi Arabian interests. Apparently the Standard Oil Co. (New Jersey) official believed that there was still a chance to obtain something more than the right to purchase crude and products from Bahrein. From Standard Oil Co. (New Jersey) executive committee memoranda, May 14, 1937.

[54] Cable from H. G. Seidel to W. C. Teagle, May 7, 1937. Also letter of July 27, 1937, from L. Lefroy to H. G. Seidel with enclosure, and letter from H. G. Seidel to E. F. Johnson, September 1, 1937.

[55] Ibid., and letter from H. G. Seidel to Guy Wellman, February 17, 1938.

However, on July 18, 1937, Gulbenkian notified the groups that in order to make the Bahrein agreement acceptable an additional paragraph would have to be added. This paragraph would, in effect, state specifically that he was to be offered the same terms and conditions as were offered the French; that if any arrangements were made between the French group and any of the other major groups arising out of the proposed agreement about Bahrein oil, Gulbenkian should be offered a share in such arrangements that bore the same ratio to the share of the French in these arrangements as that of their respective proportions in IPC.[56] This reservation was not acceptable to any of the groups. The French contended it did not refer equally to all the groups and that it tended to restrict the free trading by any group of its share of oil once the oil had been delivered. The other groups considered the clause wrong in principle as it would give Gulbenkian a right in connection with Bahrein oil that he did not possess with respect to Iraq oil.[57] Negotiations thus became deadlocked and, although all the groups, including the French, tried to work out a satisfactory compromise with Gulbenkian, their efforts were of no avail.[58] Early in 1938 one official wrote:

> We have been working for some time for a solution of the difficulty presented by Caltex in Bahrein and Arabia, and whenever a solution seems possible something has always been injected by one party or another preventing a settlement of this problem.[59]

The agency agreement.—As negotiations dragged on, the Big Three became increasingly impatient. In February 1938, Shell suggested that if an agreement were not reached the chairman of IPC should appoint each of the four major groups in IPC as agent to purchase Bahrein crude or refined products on behalf of the company.[60] Under Shell's proposal, which was called the agency agreement, Gulbenkian would not have been an agent. Since the purchases made by each agent would, so Shell contended, not be subject to the limitations of the red-line agreement, Gulbenkian would have been deprived of his share of any purchases made by the major groups. Gulbenkian immediately cabled his representative on the IPC board that:

> No intimidation or clever legal scheme will persuade me *unless tested by court that IPC can be used by majority to support their price control prevention of competition and monopolistic schemes of groups solely for their own benefit to detriment company and minority.*[61]

The groups were now faced with a dilemma. One official stated:

> * * * the situation has developed into a most complex problem allowing one of two alternatices, namely, to test the interpretation in court or try to effect a compromise covering at least the present situation.[62]

He also stated:

> * * * to test our rights as we interpret them in the court implies a disclosure of the 1928 agreement and may open a series of disclosures which, in our business interests, we might wish to avoid.[63]

[56] Letter from H. G. Seidel to Guy Wellman, February 17, 1938; minutes of group meeting, October 20, 1937. Similarly reciprocal terms were to be offered the French where special arrangements were made between Gulbenkian and the major groups.
[57] Letter from E. J. Brown, secretary of IPC, to the groups of IPC, November 8, 1937.
[58] Letter from H. G. Seidel to Guy Wellman, February 17, 1938.
[59] Letter from H. G. Seidel to Guy Wellman, February 17, 1938.
[60] Ibid., and annex II.
[61] From telegram from C. S. Gulbenkian to Nubar Gulbenkian read at IPC meeting February 17, 1938. [Italic added.]
[62] Letter from H. G. Seidel to Guy Wellman, February 25, 1938.
[63] Ibid.

Some were of the opinion that a satisfactory settlement could be had only after a court definition of certain sections of the red-line agreement. While all the groups clearly understood that under the red-line agreement purchases of crude oil produced within the red-line area would have to be made through the IPC, there was a question as to whether this restriction also applied to refined products derived from the crude produced within the area.[64] IPC lawyers and other counsel retained by the company could not agree on their interpretation of the agreement.[65]

After prolonged discussions the groups decided to compromise rather than risk court action. By May 1938 the groups had, in principle, reached an agreement whereby all parties to the red-line agreement, including Gulbenkian, could act as agents for IPC and receive their basic proportions of any crude oil and products purchased in the red-line area, which, of course, included Bahrein.[66] In July 1938, although no agreement had yet been signed, an expert was appointed to determine the price of Bahrein crude or products that the French (CFP) might be eventually required to take from Gulbenkian.[67] The prices applicable to deliveries made in 1939 for Bahrein crude and refined products were determined by the expert and communicated to the groups on September 14, 1938.[68] It is not known if the groups made many purchases of Bahrein crude or products in 1939. It appears however, that they did purchase some residuum—the residual oil left after the distillation of crude petroleum—for in May 1939 Gulbenkian wrote to CFP regarding the expert's price that—

> * * * he should make an award as to the price payable to us by yourselves for the residuum produced by the Bahrein Co. and purchased by the groups for delivery in 1939 * * *.[69]

It is also noteworthy that in September 1939, the expert fixed a full schedule of prices for Bahrein crude and products applicable to deliveries in 1940.[70] Even as early as November 1938 one official wrote:

> It is * * * the understanding between the groups that the agreement is operative, although it had not yet been signed.[71]

[64] The question apparently was first raised in 1935 when M. Piesse wrote Stuart Morgan that it might be to NEDC's "advantage for any concessions where the outlet is east of Suez to get into the hands of Standard Oil Co. of California or others rather than they should be obtained by the IPC." Such advice was predicated upon the assumption that the groups would be free to purchase from Standard of California, or others who obtained concessions within the red-line area, the refined products derived from the crude oil produced within the area, without being subject to the restrictive provisions of the red-line agreement. Letter from Montague Piesse to Stuart Morgan, February 26, 1935; also memorandum prepared by Montague Piesse, February 28, 1935, on clause 10 of the group agreement attached to letter to Guy Wellman, dated February 28, 1935.

[65] Letter from H. G. Seidel to Guy Wellman, February 25, 1938; also letter from M. Piesse to H. G. Seidel, February 24, 1938.

The pertinent phrase was in clause 10 which stated that the groups will not "* * * be interested directly or indirectly in the production of oil within the defined area or in the *purchase of any such oil otherwise than through the Turkish Company.* * * *" [italic added]. The legal issue was whether a partner in IPC could purchase Bahrein crude or refined products other than through IPC. Some lawyers thought clause 10 did not apply to the purchase of refined products derived from crude produced in the red-line area; others believed it did.

[66] Letter from R. W. Sellers, Socony-Vacuum representative on IPC, to Stuart Morgan, May 27, 1938; also letter from R. deMontaigue of CFP to J. H. MacDonald, June 29, 1938.

[67] Letter from J. Meny to Near East Development Corp., July 22, 1938.

[68] Letter from J. Meny of CFP to J. H. MacDonald, October 26, 1938.

[69] Letter from Participations and Estates (Gulbenkian interest) to the Compagnie Francaise des Petroles, May 24, 1939.

[70] Letter from J. H. MacDonald to CFP, September 14, 1939, and letter from C. S. Gulbenkian to CFP, September 18, 1939. It should be noted that the arrangements between the groups for handling Gulbenkian's share of Bahrein crude and products were similar to the existing arrangements which were in effect with respect to Iraq crude, i. e., CFP purchased Gulbenkian's share (if Gulbenkian so desired) at the expert's price; then the other major groups (Shell, Anglo-Persian, and NEDC) took one-fourth of the oil purchased by CFP, and reimbursed CFP for costs incurred.

[71] Letter from Montague Piesse to Stuart Morgan, November 11, 1938.

Thus, it appears that, temporarily at least, the agency agreement permitting the groups in IPC to purchase or off-take Bahrein crude and its products was placed in operation even though the formal documents were not signed.[72]

Big Three continue to seek a better deal with Caltex, but war ends negotiations.—Even though the agency agreement was approved in principle and appears to have been operative for a time, it was never officially signed and was continually changed until the war ended negotiations late in 1939. Moreover, the agency agreement was far short of what the major groups desired in the way of a partnership arrangement with Caltex. In March 1939—

> the groups in Iraq Petroleum Co. unanimously decided to try and negotiate a partnership agreement with the California company or Caltex covering concessions remaining in Ibn Saud's territory and the neutral zone in Arabia.[73]

A similar statement indicating the intentions of the groups was reiterated in April 1939.

> All the groups * * * were of the opinion that in principle *an attempt should be made to work out a deal with Caltex whereby each company would set aside and retain definitely explored areas or a mutually agreed to area and treat the balance of the Arabian Peninsula, including neutral zones, as areas to be pooled and operated for joint account.*[74]

But the French (CFP) would not accept such a broad partnership arrangement, and the war terminated negotiations before the groups could come to an understanding among themselves and with Caltex.[75]

Summary.—Standard of California's discovery of oil in Bahrein in 1932 and its acquisition of a large oil concession in Saudi Arabia in 1933 aroused considerable dismay among the three major groups in IPC—Anglo-Persian, Shell, and NEDC. Anglo-Persian was alarmed because Bahrein and Saudi Arabia were adjacent to Anglo-Persian's extensive oil interests in Iran. Any production inside the red line that was not controlled by IPC was considered by Anglo-Persian to be a threat to its Iranian interests. Shell and NEDC were concerned because they feared that "uncontrolled" oil from Bahrein or Saudi Arabia would force its way into the markets of Europe and the Far East, thereby unstabilizing prices and upsetting existing marketing arrangements. For a period of almost 7 years (1932–39) these three companies carried on negotiations, either individually or collectively, with the other groups in IPC, trying to work out a plan which would permit them either to share in the concessions or to have some voice in the disposition of the oil. But, in spite of the extended negotiations, the Big Three were unable during this period to work out a satisfactory arrangement either with the other groups in IPC or with

[72] The agency agreement permitting the groups to purchase Bahrein oil or red-line oil was 1 of 18 different agreements—white-paper agreements, they were called—which the groups were attempting to execute and formalize when war broke out in 1939 and suspended all discussions. It is interesting to note that to a draft of the agency agreement which was printed in 1945, Standard Oil Co. (New Jersey) attached a label upon which was typed the following: "This draft agreement sometimes called white paper No. 9, never was executed and never became effective." It is difficult to reconcile this assertion either with the above-noted statements made by Standard's representative and by some of the other groups or with the acts of the partners in selecting an expert to fix the prices.

[73] Letter from H. G. Seidel to W. S. Farish, March 17, 1939.

[74] Letter from H. G. Seidel to Stuart Morgan, April 13, 1939. [Italic added.]

[75] A letter from H. G. Seidel to W. S. Farish, April 19, 1939, described the position of the French on the question of cooperation through partnership arrangements with Caltex in Arabia as follows:

"The reluctance of the French group to accept our suggestions * * * was confirmed at our latest discussion. Their decision possibly reflects a suspicion on their part toward the major oil companies who are partners with them in the IPC, which had previously been noted in the discussions with reference to the off-take of products from Bahrein and El Hasa and in our efforts to exclude Bahrein from the red-line area. They feel that combining over such a large area with two additional major companies would proportionately weaken their relative position in these areas."

Standard of California. Their failure can be attributed in a large part to the red line agreement, which prevented them from dealing directly with Standard Oil of California.

In 1932 and 1933, when Anglo-Persian was desirous of obtaining concessions in both Bahrein and Saudi Arabia as countermeasures against Standard of California, the red-line agreement prevented Anglo-Persian from acting independently. Hence Standard of California obtained a large concession in Saudi Arabia and later extended its concession area in Bahrein. With Standard Oil of California now in possession of important concessions within the red-line area, the Big Three in 1934 sought to alter the red-line agreement in such a way as to eliminate Bahrein and a large part of Saudi Arabia. This would have given the Big Three a free hand to negotiate with Standard of California. However, the French and Gulbenkian regarded the red-line agreement as their legal safeguard in IPC and did not wish to see such a large area eliminated from red-line territory without receiving satisfactory compensation. The proposed alteration of the red line would have deprived the French and Gulbenkian of the opportunity to obtain their proportionate share of any oil taken from the excluded area. Unless granted an acceptable quid pro quo, they were unwilling to accept such a proposal. The quid pro quo which they sought was a lower price for Iraq crude. The Big Three, however, wanted a high price, fearing that the French would use a low price as a club to reduce product prices in France, where the Big Three were important marketers. In February 1936, they agreed to lower the price of Iraq crude, while the French and also Gulbenkian consented to permit the Big Three to continue further negotiations with Standard of California.

At the same time that the Big Three were trying to come to an agreement with the French on the price question, they were also conducting negotiations with Standard of California. These negotiations appear to have been initially unsuccessful.

Following the compromise on the price question, the Big Three tried to reach an agreement which would permit them to purchase Bahrein's oil without sharing their purchases with the other groups in IPC. The French and Gulbenkian demanded their proportionate share of any purchases. To further complicate matters, the groups could not agree among themselves on whether the red-line agreement applied to products refined from crude produced in two red-line areas. Hence by the end of 1937 negotiations were deadlocked. Also, Standard of New Jersey was not anxious to negotiate a waiver of the red line until it could see more clearly what the outcome would be. Standard of California had a refinery almost completed at Bahrein; it had purchased a one-half interest in the marketing facilities of Texas Co. east of Suez (for which Texas received a one-half interest in the Bahrein and Saudi Arabian concession); and Jersey Standard understood that the new California-Texas Co. had plans for entering the Indian market.

In 1938, Shell suggested that IPC appoint all groups as agents, except Gulbenkian, with power to purchase Bahrein crude and products on behalf of IPC. Gulbenkian, however, vigorously objected and threatened a test of the matter in court, which, to the embarrassment of the groups, would have disclosed the red-line agreement. Rather than risk a court test, the groups agreed in May 1938 to make

all parties, including Gulbenkian, agents of IPC, thereby permitting all groups to receive their basic proportions of oil purchased from Bahrein. Any group was free to make purchases providing all other groups were notified. Apparently this agreement, called the agency agreement, was in effect during 1938 and 1939, although no formal documents were signed. The agency agreement, however, was far short of what the Big Three wanted, and they were in the process of working out a new arrangement when World War II ended discussions late in 1939. Thus, in the end, the red-line agreement, which was adopted for the purpose of limiting competition among the groups in IPC, backfired when the groups wanted to forestall competition by a nonmember.

ADDITIONAL IPC CONCESSIONS

The failure of IPC to secure concessions in Bahrein and Saudi Arabia should not obscure the fact that elsewhere in the Middle East the company was successful in closing the open door to outsiders. The principal competitors for concessions were British Oil Development Co., Ltd., and Standard Oil Co. of California. When these companies became interested in concessions in Iraq and other Middle East countries, IPC sought to exclude them by the simple device of buying up concessions within the red-line area. So successful were its efforts that by the end of 1944 IPC was operating in over 467,055 square miles of territory in various parts of the area. The company had extended its operations by exploration permits and concession agreements over an area larger in size than the States of Texas, Oklahoma, Arkansas, and Louisiana combined.[76] In addition, IPC attempted, though without success, to extend further its area of control by seeking concessions or exploration permits in Turkey and in the neutral zones of Kuwait and Saudi Arabia.

The operations carried on by IPC are conducted through a series of subsidiary and affiliated companies, which are named on chart 20. This section describes the scope of IPC operations, both within and outside Iraq, in its own name and through its various subsidiary and affiliated companies.

Within Iraq

Iraq Petroleum Co., Ltd.—This is both the parent holding company and an operating company. As has been noted, IPC secured its first concession in Iraq in 1925, which was originally limited to a total area of 192 square miles (24 plots of 8 square miles each). In 1931, the original concession was revised, and IPC was given an exclusive concession over the whole area in Iraq east of the Tigris River except a small area held by the Anglo-Iranian Oil Co. on the Iranian border.[77] This is the only concession which IPC holds directly. All others are controlled by subsidiary and affiliated companies.

It is from the area east of the Tigris that IPC has obtained most of its oil. The Kirkuk field is located here and is connected by a system of pipelines to the Mediterranean, with terminals at Tripoli and Haifa.

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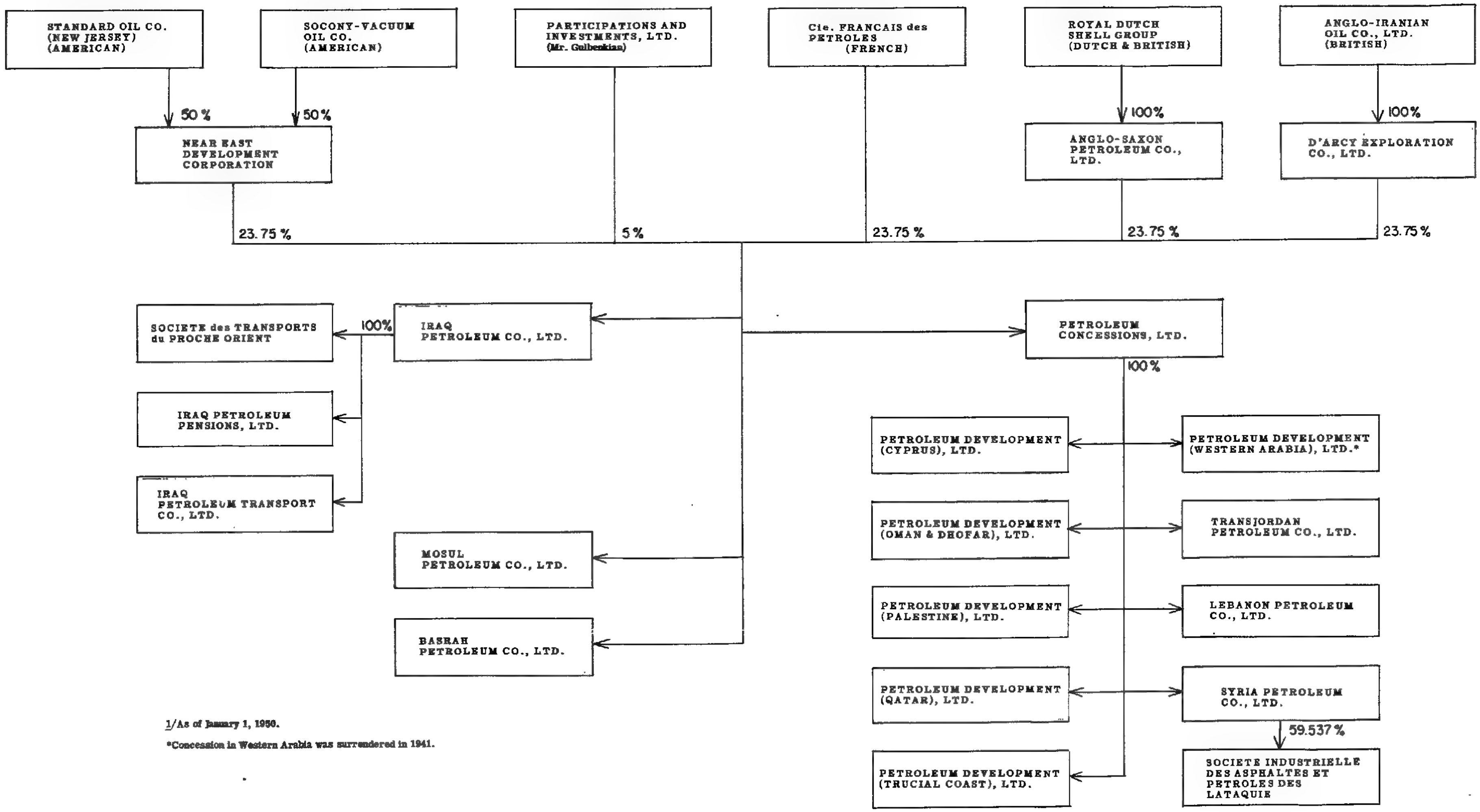
[76] Brief Historical Outline of Oil Developments to Date, op. cit.

[77] The Anglo-Iranian Oil Co. holds the concession over a small area in Iraq which borders on Iran. This territory was, for some time, in dispute between Turkey and Persia; but, when the boundary was finally settled, the territory formerly claimed by Persia was transferred to Turkey, which had control over Mesopotamia, now Iraq. In view of claims by a subsidiary of Anglo-Iranian Oil Co., Ltd., to the Persian territory which was granted to D'Arcy in 1901, this company retained its concession rights to the territory when it was transferred from Persia to Iraq. (Memorandum from Guy Wellman to the members of the American group, January 18, 1928, and letter from Walter C. Teagle to Guy Wellman, November 6, 1924.)

CHART 20.

CORPORATE ORGANIZATION OF IRAQ PETROLEUM COMPANY, LTD., AND ASSOCIATED COMPANIES [1/]



1/ As of January 1, 1950.

*Concession in Western Arabia was surrendered in 1941.

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Mosul Petroleum Co., Ltd.—In addition to the area east of the Tigris River, the IPC group, through an affiliate, Mosul Petroleum Co., Ltd., holds a concession over all of the lands of Iraq west of the Tigris River and north of the thirty-third parallel of latitude. This concession dates from April 20, 1932, when the British Oil Development Co., Ltd. (BOD), obtained a 75-year lease of these lands. BOD was first formed by British and Italian interests, but later included some German and Swiss capital. On November 23, 1932, control of BOD passed to Mosul Oil Fields, Ltd., a corporation set up by Italian, British, and German interests for the purpose of acquring BOD's shares.[78]

IPC had long been disturbed because this concession was held by an outsider. On October 14, 1938, IPC formed Mosul Holdings, Ltd., to acquire the shares of Mosul Oil Fields, Ltd. By 1937, practically all the shares had been acquired. In 1941, IPC changed the name of Mosul Holdings, Ltd., to Mosul Petroleum Co., Ltd. The latter is wholly owned by the owners of IPC, and now holds the oil concession for all the territory west of the Tigris River formerly held by BOD. In 1944, BOD and Mosul Oil Fields were dissolved.[79]

Before the discovery of the Kirkuk fields, the concession held by Mosul Petroleum Co., Ltd., was considered one of the more desirable oil prospecting areas in Iraq. Although more than 140 wells have been drilled and a considerable amount of oil has been found, most of the oil is so heavy and sulfurous that its commercial possibilities are questionable. There is one field which produces a crude comparable to Kirkuk crude; but, as of 1950, this area has not been sufficiently developed to produce oil in commercial quantities. Ultimate reserves of the whole concession have been estimated by the same unofficial sources mentioned above at 5 billion barrels.

Basrah Petroleum Co., Ltd.—On July 29, 1938, another IPC affiliate, Basrah Petroleum Co., Ltd., obtained a concession over the last remaining free portion of Iraq; namely, the Basrah area which lies at the head of the Persian Gulf. This concession is for 75 years and covers all the lands in Iraq not already granted to IPC, Mosul Petroleum Co., Ltd., or Anglo-Iranian Oil Co. (AIOC).[80]

The Basrah area is considered to be particularly attractive because of its proximity to the productive Burghan field in Kuwait. Since World War II, several productive wells have apparently been completed; for by early 1951 a 72-mile 12-inch pipeline had been constructed from Zubair, the oil-producing center, to Fao, a shipping point on the Persian Gulf.[81] The ultimate potential of the Basrah area has been unofficially estimated to be 20 billion barrels.[82]

Outside Iraq

Outside of Iraq proper, but still within the red-line area, the IPC groups hold many concessions and exploration permits through a holding company, Petroleum Concessions, Ltd., which was formed in October 1935. This company and its subsidiaries were organized by IPC to operate in the red-line area outside of Iraq because of the fact that IPC had on its board of directors a representative of the

[78] Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit.; and Brief Historical Outline of Oil Developments to Date, op. cit.
[79] Ibid.
[80] Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit.
[81] Minutes of Group Meeting, January 12, 1950 (Files SONJ, part 3-D), and World Oil, April 1951, p. 254.
[82] Brief Historical Outline of Oil Developments to Date. op. cit.

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Iraq Government, and it was considered inadvisable for a member of that Government to participate in the negotiations and decisions concerning Middle East countries over which Iraq has no jurisdiction.[83] All the provisions of the red-line agreement were made applicable to the operations of Petroleum Concessions, Ltd., and its subsidiaries.

In 1944, the total area held outside of Iraq for exploration by Petroleum Concessions, Ltd., and its subsidiaries was more than 186,000 square miles. The numerous concession rights and exploration permits thus held in the various countries of the Middle East are discussed below.

Petroleum Concessions, Ltd.—Although this company is primarily a holding company, it nevertheless holds directly an exploration permit over Hadhramaut, in the Aden Protectorate, which is an area lying in the southern part of Saudi Arabia adjacent to the Gulf of Aden. This exploration permit was first granted on November 19, 1938, and has been extended on five occasions, each for a period of 2 years, beginning in January 12, 1940.[84] By April 1940, aerial and geological surveys of some 100,000 square miles of the area had been completed but no oil had been discovered. As of 1950, official sources had not indicated any discoveries of oil in the area.

Petroleum Development (Qatar), Ltd.—This company is a subsidiary of Petroleum Concessions, Ltd., and holds a 75-year concession over all of Qatar (about 4,100 square miles, or 2,600,000 acres).

Interest by IPC groups in Qatar dates from September 1932, when Anglo-Persian obtained an exclusive license for a 2-year geological examination of the Qatar Peninsula, largely as a preclusive measure in order to keep the area out of the hands of Standard Oil Co. of California. This independent act by Anglo-Persian was a violation of the self-denying clause of the red-line agreement. However, since Anglo-Persian had acted in the interest of IPC and without any intent of personal benefit, the groups agreed that Anglo-Persian should not be penalized and that the Qatar license should remain in Anglo-Persian's name as the nominee of IPC.

In 1933, when a geological survey showed Qatar to have favorable oil prospects, IPC authorized Anglo-Persian to negotiate a concession with the Sheikh of Qatar. On May 17, 1935, the company was granted a 75-year concession. IPC then formed Petroleum Development (Qatar), Ltd., which took over the concession from Anglo-Persian on February 5, 1937, in accordance with the provisions of the red-line agreement. Drilling began in October 1938, and a year later considerable quantities of oil were discovered. The first well came in with a showing of 2,500 barrels daily, and by 1940, after further production tests, its estimated flow was about 4,000 barrels of 34° API crude per day. Operations at Qatar were disrupted with the war. Drilling stopped and all wells were plugged as a defensive measure. After the war, development was pushed rapidly, additional wells were drilled, and a 51-mile pipeline was completed to the east coast of the peninsula.[85] By 1950, Qatar was producing an average

[83] Notes on Iraq Petroleum Co., Ltd., and affiliated companies, op. cit.

[84] Summary of Middle East Oil Developments, Arabian-American Oil Co., 2d edition, 1948, and Iraq Petroleum Co., Ltd., and associated companies, Collection of Conventions, Agreements, and Connected Documents Affecting the Operations of the Iraq Petroleum Co., Ltd., and its associated companies, compiled in the head office of the companies in London, June 1949.

[85] Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit.

of 33,800 barrels of crude per day.[86] The ultimate reserves of Qatar have been tentatively estimated by an IPC group to be 3 billion barrels, which is considerably in excess of published estimates of proven reserves.[87]

Petroleum Development (Western Arabia), Ltd.—This subsidiary of Petroleum Concessions, Ltd., was formed in 1936 to take over a 60-year concession in an area of about 55,000 square miles extending along the western coastal area of Saudi Arabia from Yemen to Transjordan. After a geological examination, it was decided that the area had practically no oil-bearing possibilities, and in March 1941, the concession was surrendered.[88]

Other Middle East areas.—IPC also holds oil rights in other Middle East areas, which thus far have proved to be unproductive.

Through Petroleum Development (Trucial Coast), Ltd., it holds concessions and exploration permits covering several of the small sheikdoms along the Trucial Coast, including Umm-al-Quwain, Dubi, Sharjar, Ras al Khaimah, Abu Dhabi, and Ajman. All of these sheikdoms lie along the Persian Gulf and border on Saudi Arabia. In September 1936, IPC formed Petroleum Development (Trucial Coast), Ltd., a subsidiary of Petroleum Concessions, Ltd., to hold these various concessions and permits.[89] As of 1950 no oil had been discovered in any of the Trucial Coast sheikdoms.

Another subsidiary of Petroleum Concessions, Ltd., Petroleum Development (Oman and Dhofar), Ltd., was incorporated in 1937 for the purpose of conducting operations in leased areas of Oman and Dhofar, which had been obtained on June 24, 1937, by agreements between the Sultanate of Muscat and Oman and Petroleum Concessions, Ltd.[90] As of 1950, no crude oil had been discovered in Oman or Dhofar, and IPC has considered abandoning these areas.

In February 1938, Syria Petroleum Co., Ltd., also a subsidiary of Petroleum Concessions, Ltd., was awarded a 75-year concession over about 60,000 square miles of Syrian territory. This grant was ratified by the Syrian High Commissioner on March 25, 1940.[91]

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86 World Petroleum, January 1951, p. 481.

87 Brief Historical Outline of Oil Developments to Date, op. cit., p. 91.

Proven reserves in 1949 were estimated at 500 million barrels (DeGolyer and MacNaughton, op. cit.).

As noted heretofore, Anglo-Iranian and American groups were not always in agreement in regard to Qatar developments. The American group desired more oil in the Persian Gulf in order to supply Standard-Vacuum with crude for its far-eastern markets, but Anglo-Iranian was not enthusiastic about pushing Qatar, as it feared more oil in the Persian Gulf would affect adversely its interests in Iran and Kuwait.

88 Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit. Iraq Petroleum Co., Ltd., and Associated Companies, op. cit.

89 Oil concessions covering the sheikdoms of Dubar and Sarjah were obtained in September 1937; the Kalbah concession covering an area of 600 square miles was secured in 1938; and in January 1939, a concession over the sheikdom of Abu Dhabi was granted. All three of these concessions were to run for a period of 75 years. An exploration permit covering approximately 700 square miles of the sheikdom of Ras al Khaimah was granted to Petroleum Development (Trucial Coast), Ltd., in December 1938. Similar permits covering an area of 100 square miles of Ajaman and the entire sheikdom of Umm-al-Quwain were obtained in March 1939 and March 1945, respectively. These permits were renewable and required only nominal royalty payments (Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit., and Iraq Petroleum Co., Ltd., and Associated Companies, op. cit.).

90 These agreements provided for an option period during which the company could at any time take a concession over the leased areas. On May 14, 1944, the company, Petroleum Development (Oman and Dhofar), Ltd., exercised its rights under the option and acquired a concession over the areas. This concession, like many others held by IPC, is for 75 years and gives the company the exclusive right to search for, explore, drill, produce, refine, sell, and export any crude petroleum found in the areas (Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit., and Iraq Petroleum Co., Ltd., op. cit., and minutes of group meeting May 5, 1949, and June 9, 1949, and July 13, 1950).

91 The concession was to apply to all of Syria north of the parallel passing through Damascus, except the territory of the Sandjak of Alexandretta. Two-thirds of the initial area was to be surrendered within 25 years—one-third at the end of the third year and one-third at the end of the twenty-fifth year (Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit.; and Iraq Petroleum Co., Ltd., Collection of Conventions, Agreements, Documents, etc., op. cit.).

Before World War II, a number of shallow wells and a few deep test wells were drilled in Syria, but all were nonproducers. During the war all drilling and geological work was suspended. In 1943, a moratorium agreement was signed by the company and the Syrian Government. It relieved the company of all obligations under the concession agreement, except annual rental payments, until 2 years after the signing of an armistice between Great Britain and Germany.[92]

Petroleum Development (Cyprus), Ltd., another subsidiary of Petroleum Concessions, Ltd., obtained, in April 1938, a 2-year exploration permit applicable to about 20,000 square miles of the island of Cyprus. The permit was renewable every year and was continued until 1948. But when geological surveys and field work indicated that oil possibilities were remote, the company announced, in December 1948, its intention to abandon operations in Cyprus and not to seek a further renewal of its exploration permit.[93]

Petroleum Development (Palestine), Ltd., also a subsidiary of Petroleum Concessions, Ltd., held at the close of 1950 some 29 prospecting licenses applicable to more than 5,000 square miles of territory in Palestine.[94] The company ceased all activity in this area during the war because of the impossibility of performance, but operations were subsequently resumed. The company started drilling a test well near Gaza sometime in 1947. Drilling was suspended in February 1948, when political disturbances made it difficult and dangerous to carry on. Apparently the licenses are still in effect.[95]

It took IPC several years to get a foothold in Transjordan. In February 1938, IPC formed Petroleum Development (Transjordan), Ltd., a subsidiary of Petroleum Concessions, Ltd., to apply for prospecting licenses in Transjordan. Thirty-seven licenses were applied for but none was granted. In May 1947, the company obtained a 75-year concession in Transjordan. Although some geological and geophysical work have been performed there, no wells have been drilled.[96] Transjordan is apparently not a promising oil-producing area, for in 1949 IPC considered abandoning its concession.[97] But by early 1950 no final action had been taken.[98]

IPC also obtained an oil exploration permit from the Lebanese Republic in March 1938, covering an area of five contiguous squares whose sides were 10 kilometers long. The permit was originally held by Petroleum Concessions (Syria and Lebanon), Ltd., a subsidiary of Petroleum Concessions, Ltd. Some drilling was done in Lebanon in 1948, but without results, and the general manager of IPC indicated that he would recommend abandonment of the area.[99]

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[92] Notes on Iraq Petroleum Co., Ltd., and Affiliated Companies, op. cit.
[93] Ibid., and IPC Conventions, Collections, etc., op. cit.
[94] Eleven of these licenses were dated February 24, 1939, and 18 were dated July 21, 1939.
[95] Notes on IPC and Affiliates, op. cit., and IPC Conventions, Collections, etc., op. cit.
[96] Ibid.
[97] Minutes of group meeting, June 9, 1949.
[98] Subsequent to obtaining the concession the name of Petroleum Development (Transjordan), Ltd., was changed to Transjordan Petroleum Co., Ltd.
[99] Activity in Lebanon was suspended during the war. In 1948, the permit was renewed for a period of 3 years. When operations were resumed after the war, the name of Petroleum Concessions (Syria and Lebanon), Ltd., was changed to Lebanon Petroleum Co., Ltd. (Iraq Petroleum Co., Ltd., Associated Companies, op. cit., and minutes of group meeting, October 21, 1948).

Miscellaneous subsidiaries and affiliates.—In addition to holding concessions and oil exploration permits, IPC has formed subsidiaries to conduct air transportation (Iraq Petroleum Transport Co., Ltd., and Transports du Proche Orient); to administer a pension program (Iraq Petroleum Pensions, Ltd.); and to manufacture asphalt in Syria (Societe Industrielle des Asphaltes et Petroles de Lattique).[1]

SOME OPERATING POLICIES, PROBLEMS AND RESULTS

As IPC extended its area of operations inside and outside Iraq it was confronted with a variety of quasi-political and financial problems, particularly problems with the Iraq Government. The way these problems were resolved, the operating policies established, and the results stemming therefrom give historical perspective and insight into the internal operations of IPC. They also reveal something about the underlying philosophy which guided IPC, the first joint venture in the international oil business.

Revision of the Anglo-Iranian royalty.—When the American group secured its 23.75 percent interest in IPC, the D'Arcy or Anglo-Persian group (later Anglo-Iranian) relinquished one-half of its share interest in IPC (TPC at that time) and in return was granted 10 percent overriding royalty on all crude obtained from the 24 plots of 8 square miles each which TPC could select under the Iraq concession agreement of March 14, 1925.[2] In other words, D'Arcy was entitled to 10 percent of the oil found in these areas, free of cost at the gathering stations in the field, and would have to pay only the cost of handling and transportation to seaboard.

As previously noted, the Iraq concession of 1925 was revised in March 1931, and IPC was granted a blanket concession over 32,000 square miles of territory east of the Tigris River.[3] There then arose the question whether Anglo-Persian's 10 percent royalty should continue to apply to only the 24 plots or should be extended to the entire area covered by the revised agreement. The royalty question also arose in connection with IPC's interest in other concessions within the red-line area. After lengthy negotiations the groups arrived at a compromise settlement in November 1934, which stipulated that D'Arcy would be entitled to a 7.5-percent royalty on such oil as was produced from the 32,000 square miles covered by the revised Iraq concession of March 24, 1931, the oil to be delivered free of cost at the field, with IPC paying the royalty due the Iraq Government.[4]

Tax matters.—Taxes were an early and continuing problem to the groups in IPC. As has been previously noted, tax considerations influenced the groups' decision to give each owner his proportionate share of the crude produced rather than to operate IPC primarily for profit.[5] Since IPC was a British-chartered company, the British groups would not have been subject to double taxation. The non-British groups, however, did not relish the idea of having the earnings of IPC taxed once by the British Government and again by their own governments. As a result, the non-British groups spent considerable

[1] Notes on IPC Co. Ltd., and Affiliated Companies, op. cit., and Corporate Chart of Group's Interest in the Middle East.
[2] See p. 65.
[3] See p. 70.
[4] Letter from Sir William Fraser to H. G. Seidel, November 13, 1934. Also Notes on Iraq Petroleum Co., Ltd. and Affiliated Companies, op. cit.
[5] See p. 61.

time investigating various plans for minimizing tax payments. The profits of IPC would obviously have to be held to a nominal figure if large taxes on its operations were to be avoided. Eventually, in March 1934, IPC obtained the consent of the British Board of Inland Revenue to sell IPC crude to the groups at less than market prices without running the risk of increasing its income-tax liability.[6] There then followed an agreement by IPC to price crude to the groups at a level sufficient to cover British income tax cost plus 1 shilling profit.

But the income tax-cost pricing scheme was not made effective immediately. Three of the groups (NEDC, Anglo-Persian, and Shell) wanted to use it as a bargaining point in their negotiations with the French in regard to the exclusion of Bahrein and Saudi Arabia from the Red line. Moreover, the groups could not reach an agreement concerning depreciation and prices. The groups had chartered a Canadian corporation, Mediterranean Pipelines, Ltd., to construct and operate the pipeline to the Mediterranean. Thus, if they adopted the British income tax price scheme, they could not include in IPC's costs sufficient charges to cover depreciation and a return on their investment in the pipeline. On the other hand, if they increased the depreciation charges on the pipeline and permitted the pipeline company to charge rates sufficient to cover the additional depreciation plus a return on investment, they ran the risk of having to pay substantial taxes to the Canadian Government.[7] In addition to these obstacles, the Big Three, at least for a time, did not want to adopt any plan which did not result in a relatively high price for crude.[8] As a solution to this dilemma, the general manager of IPC, J. Skliros, offered a three-point compromise: (1) that IPC operate the crude producing fields; (2) that Mediterranean Pipelines, Ltd., be made a British company; and (3) that a third company (Hyde Park) be registered in the Channel islands to buy the crude from IPC at income tax cost and sell it to the groups at group agreement cost. In support of his plan Mr. Skliros commented as follows:

> With three such companies, and with three sets of accounts, it might be possible so to adjust figures as to render the non-British groups liable to a minimum of British taxation. Such a triple string can maintain crude prices to a sound businesslike level; refining and marketing profits can be kept at figures that will not excite the cupidity of Government Exchequers; the low price of Iraq crude need not be blatantly advertised; and if the Hyde Park Co. does return an unconscionable dividend to its shareholders, I suppose that the only comment that can be made thereon is one entirely flattering to the business acumen of those shareholders for investing their money in such a venturesome concern as the Hyde Park Co.[9]

Despite his eloquence and reasoning, the groups did not accept Mr. Skliros' compromise, but rather, made a decision in favor of low taxation as against a high price for crude. They agreed to liquidate the pipeline company, transfer all pipeline operations to IPC, and price crude to the groups on the basis of management's estimate of British income tax cost plus 1 shilling profit per ton. Under this plan IPC's

[6] Letter from John Cadman to Board of Inland Revenue, March 21, 1934, and reply by C. Gordon Spry of Board of Inland Revenue, March 23, 1934.

[7] Mediterranean Pipelines, Ltd. (MPL), also presented another problem, namely, recognition by the governments of Palestine and Transjordan, which could be obtained only if IPC surrendered its rights to operate pipelines. Recognition was needed in order to validate MPL's transit privileges, but if IPC gave up its right to operate pipelines, it lost unit control over MPL. Memorandum from J. Skliros to the groups, Reflections on the Group Agreement, October 23, 1933.

[8] Letter from M. Piesse to Stuart Morgan, March 26, 1936.

[9] Memorandum from J. Skliros to the groups, Iraq Petroleum Co., Ltd., February 4, 1935.

profits would, of course, be nominal and its tax liability to the British Government would be relatively small.

As would be expected, Gulbenkian was also interested in minimizing his tax liability. In 1931, when IPC chartered Mediterranean Pipelines, Ltd., in Canada, Gulbenkian requested, and the groups agreed to, the establishment of Participations and Investments (Newfoundland), Ltd., to hold Gulbenkian's shares in the pipeline company. Gulbenkian's shares in IPC were held by Participations and Investments (Canada), Ltd. At that time he apparently thought that most of the profit of the IPC venture would be deposited with the pipeline company. In view of the new income tax that was coming into effect in Canada, Gulbenkian concluded that he would receive better tax treatment if he let the Newfoundland corporation rather than the Canadian company hold his interest in the pipeline company.[10]

Again in 1935, when it appeared that Canada might subject his Canadian company (Participations and Investments, Ltd.) to a substantial increase in taxes, Gulbenkian formed a new company, Participations and Investments (Monaco), in the Principality of Monaco, France, to purchase at a small or no profit the crude received from IPC by Gulbenkian's Canadian company. The Monaco company then took the place of the Canadian company, with the result that the profits from Gulbenkian's crude were obtained primarily by the Monaco corporation, which was liable to relatively small taxes.[11] In 1938, Gulbenkian changed the name of his Monaco corporation to Participations and Estates (Monaco), Ltd.[12]

Royalty problems with the Iraq Government.—The matter of royalties was perennially discussed between IPC and the Iraq Government. The vague wording of the Iraq convention of 1925 promoted disputes regarding future royalty payments.

The Iraq Convention of March 1925, and as revised in 1931, provided that IPC should pay a royalty of £400,000 (gold) per year until such time as regular exports of crude commenced. Thereafter the royalty was to be 4 shillings (gold) per ton on the quantity of petroleum produced annually, with total annual payments to be not less than £400,000 (gold). This tonnage royalty of 4 shillings was to be effective for a period extending 20 years beyond the completion of a pipeline and the initiation of export shipments, i. e., from 1934 to 1954. For each 10-year period thereafter the 4-shilling rate was to be increased or reduced by a percentage figure. This was the percentage by which the profit or loss of IPC during the last 5 years of the 20-year base period was greater or less than during the first 15 years of the base period.[13] The minimum rate of royalty was specified to be 2 shillings (gold) and the maximum rate 6 shillings (gold).[14]

10 Letter from M. Piesse to Stuart Morgan, July 13, 1931.

11 Ibid. It will be recalled that Gulbenkian and CFP signed a sale of oil agreement on July 31, 1928, the terms of which provided for CFP purchasing Gulbenkian's share of IPC crude at a price fixed by an export, and that the other three major groups (Anglo-Persian, NEDC, and Shell) signed an agreement in 1929 with CFP, unknown to Gulbenkian, whereby CFP would deliver to each of the three groups one-fourth of the oil received from Gulbenkian and each of the groups would, in turn, pay CFP for their respective shares of Gulbenkian's oil plus the cost of carrying out the Gulbenkian agreement. (See ch. III, p. 63.)

12 Letter from J. Meny to T. H. Tackrah, May 30, 1938.

13 "Profit or loss" was defined as the difference between the average market price per ton of the petroleum sold and the average cost per ton of producing, transporting, refining, and distributing the same. "Average market price" per ton was defined as the total price (ascertained as closely as possible) obtained for the products divided by the total tonnage of such products. "Average cost" meant the estimated total cost of producing, transporting, refining, and distributing the said products divided by the total tonnage sold.

14 Article 10 of the Iraq Convention made the 24th day of March 1931, between the Iraq Government and the Iraq Petroleum Co., Ltd.

The purpose of this royalty provision was to enable the Iraq Government to obtain a higher royalty if the profits of IPC increased, while the company would be favored by having smaller royalty payments if profits declined. However, it was practically impossible to obtain a workable definition of the terms included in the royalty provision in view of the manner in which IPC was operated. As has been noted, the crude produced in Iraq was sold to the IPC groups at an arbitrary price; the crude was then refined by the respective groups, and the profits obtained from the refined products were retained by the transporting, refining, and marketing affiliates operated by the respective owners of IPC. Therefore, most of the profits from IPC's operations were obtained by the groups themselves, and the nominal profits earned by IPC could not be used as a basis for adjusting royalty payments. Moreover, IPC could not supply data on costs and prices of refined products; these could be obtained only from the records of the refining and marketing subsidiaries of the groups.

Inquiries as to how the royalty provision would be administered began in early 1935, following the beginning of export shipments late in 1934. For these shipments, the groups arbitrarily set 18 shillings per ton as the price at which Iraq crude would be sold to the respective groups. In February 1935, the Iraq Government wrote IPC as follows:

> The decision of the board of directors of your company regarding the sale price of crude oil from seaboard to "shareholders" has an important relation with the application of article 10 of your company's convention in respect of specifying the royalty. We request you, therefore, to give us detailed information as to the actual average price per ton, no matter where the selling place may be, together with the average expenses per ton, and to explain the reasons for its being fixed at 18 shillings.[15]

The groups were in a quandary as to how to answer this inquiry. The Iraq Government had been dissatisfied with the royalty provisions of the agreement prior to its signing in 1931. Some persons in IPC believed that the inquiry of February 1935 was an attempt to reopen the subject. As explained by one official, the Iraq Government's objection to the royalty provision was based on the ability of IPC to fix the average market price at will by selling crude at arbitrary prices, ignoring market values of the refined products. Under such circumstances there was nothing to prevent IPC from adjusting prices during the base period following the completion of the pipeline so as to bring down the royalty payable 20 years thereafter to the minimum of 2 shillings gold for the following 10 years.[16]

IPC answered the Iraq Government's inquiry by saying that the price of 18 shillings per ton for Iraq crude during 1935 was a purely arbitrary price and had no relation either to average cost or to average market price as referred to in article 10 of the agreement. It expressed willingness to meet with the Iraq Government to formulate practical methods of obtaining the data which would be needed in 1954 for fixing the rate of royalty.[17]

[15] Letter of Minister of Economics and Communications, Bagdad, to Iraq Petroleum Co., Ltd., February 11, 1935.

[16] Memorandum from J. Skliros to the groups, February 28, 1935. In this memorandum Mr. Skliros, general manager of IPC, took the position that the company had the right to sell at 18 shillings, but it did not necessarily follow that the Iraq Government had to accept the resultant profit or loss as the basis for the first of the 20 years trading date on which to calculate subsequent royalties. "It will not help us to say that Government cannot challenge the soundness of that data now and that they must wait until 20 years of trading have elapsed."

[17] Memorandum from J. Skliros to the groups, May 29, 1935.

On May 14, 1935, the Iraq Government replied, requesting IPC to make specific suggestions relating to the application of article 10 of the company's convention.[18] The question what to do about the Iraq royalty provision was thoroughly discussed at a group meeting on July 1, 1935. The French (CFP) suggested that the Iraq Government should be informed that the royalty provision was unsatisfactory, and that the rate of royalty should not be modified according to the company's profit and loss account, as the account could be altered from time to time according to the company's inclination. They held that it would be far more preferable from every point of view to base the royalty on market price, which was not within the company's control.[19] Instead of adopting CFP's suggestion, the groups decided to postpone action. It was agreed that the managing director should inform the Iraq Government that the general manager who was then in the Near East, would shortly be returning and that on his return the managing director would take up with him the company's proposal for discussions with the Iraq Government.[20]

But the Iraq Government was not satisfied with this postponement. They wrote IPC on July 23, 1935:

> It was our desire to know your proposals in writing on the subject of applying a formula for the revision of the rate of royalty in the year 1954 before the return of the general manager of your company—who is now on leave—in order to enable us to study your proposals before discussing the subject with him.[21]

The royalty question was discussed at various times in 1935 and 1936; but little, if any, progress was made toward a settlement. In 1937, the Iraq Government asked IPC to submit the accounts and information as required by article 10 of the convention. The accounts were to be based on the actual market prices for the oil products, and were to contain, among other things, the prices obtained from the sale of the crude-oil products, the weight of such products (which would enable the Iraq Government to compare the prices with the prevailing world prices), and the cost of transporting, producing, refining, and distributing Iraq crude oil only.[22] The Iraq Government had previously been informed that IPC could not supply such data. They had been told that IPC disposed of Iraq crude to its own constituents, who mixed the Iraq crude with the crudes of different countries, and that the only figure IPC could furnish was the "average cost per ton," including costs of production and transportation to points where the oil ceased to be IPC's property. The Iraq Government had also been informed that it was not feasible to ascertain the profits made by the buyers of Iraq crude on their sale of refined products containing a percentage of Iraq crude. Nonetheless, the Iraq Government still insisted that IPC had offered to "formulate practical methods of ascertaining the necessary data which may be needed in 1954 for fixing the rate of royalty.[23]

[18] Ibid. The general manager of IPC took the position that the Iraq Government had read into IPC's offer to formulate practical methods of ascertaining the necessary data as an offer to lay before them concrete proposals, and the general manager suggested that the IPC discuss the matter at a group meeting. He also informed the groups that it was his impression that the Iraq Government would require a revision of article 10 which would give an unequivocal definition of the gold content of the 4 shillings' royalty. The Iraq Government apparently was greatly disturbed over the devaluation of gold in the United States.

[19] From minutes of group meeting, July 1, 1935.

[20] Ibid.

[21] From memorandum from Mr. Skliros to the groups, August 13, 1935.

[22] J. Skliros' memorandum to the groups, July 30, 1937. He also notified the groups as follows: "So far we have done nothing to implement the implied promise that we would submit some practical alternative to the unworkable formula contained in the convention; this issue raises periodical friction between the Government and the company. * * *"

[23] Ibid.

In September 1937, the royalty problem was discussed at another group meeting. It was agreed that the shareholding companies would nominate experts in marketing matters to assist the managing director of IPC in preparing a formula for possible submission to the Iraq Government.[24] The members of the committee met several times to work out a formula. In November 1937, it was reported that a formula under consideration by the committee provided that the yearly market price of Iraq crude should be the price f. o. b. Mediterranean terminal, if such a price existed; and, if not, it should be a fair market price as determined by an independent expert selected by the Government and the company. Cost was to be the cost of delivery f. o. b. Mediterranean terminal as certified by the company's auditors.[25] In December 1937, the board of directors of IPC decided that the managing director should discuss this formula with the Iraq Government on his forthcoming visit to Iraq.[26]

It is not clear what sort of arrangement IPC made with the Iraq Government between 1937 and 1947. It is apparent, however, that no final settlement was reached in 1937, for in April 1947 the Iraq Government requested IPC to supply figures on the cost price of crude at the Iraq frontier and to submit such additional data as would apply under the royalty clause of the convention agreement.[27] In April 1948, at a meeting of the board of directors, the managing director of IPC referred to the need for a revision of the formula, since under article 10 of the convention the rate of royalty would come up for revision in 1954. Since, in his view, the existing formula could not be operated because of the impossibility of collecting the required data, he felt that a revision was the only solution.[28] But no revision of the royalty rate was made at that time. On March 18, 1949, almost a year later, the Iraq Government suggested an immediate revision of article 10 of the IPC convention, instead of waiting until 1954. It appears that the Iraq Government was willing to discuss new royalty terms based on a sliding scale and on world market prices.[29] As recently as June 1950, however, the groups in IPC were still carrying on discussions with the Iraq Government regarding the royalty to be paid.[30]

Prices charged Iraq consumers for petroleum products supplied by IPC.—Under the Iraq convention of March 1931 IPC was required to supply Iraq's local requirements for petrol, kerosene, and fuel oil. Until March 14, 1955, the price in bulk for these products was to be the equivalent in Iraq currency of 10.68 pence per Imperial gallon for petrol, 7 pence per Imperial gallon for kerosene, and 2.25 pence per Imperial gallon for fuel oil.[31] These base prices, however, were to be increased or decreased from time to time in accordance with variations in world prices and in any distribution costs or other working expenses outside the control of IPC.[32]

In order to make the pricing provisions workable, it was, of course, necessary to come to some agreement as to the manner in which prices

[24] Minutes of meeting of directors, September 16, 1937.
[25] Minutes of group meeting, November 17, 1937.
[26] Minutes of meeting of directors, December 16, 1937.
[27] Minutes of group representatives, April 18, 1947.
[28] Minutes of meeting of directors of IPC, April, 19 2948.
[29] Notes on meeting of group representatives, March 18, 1944.
[30] Notes on Special group meeting, June 15, 1950.
[31] After March 14, 1955, the Iraq prices were to be fixed by further agreement between the company and the Iraq Government.
[32] Arts. 14 and 15 of the Iraq Convention, March 24, 1931.

of oil products sold in Iraq were to be increased or decreased in accordance with variations in world prices. The Iraq Government and IPC solved this problem by agreeing upon the following procedure:

> * * * that prices shall be increased or decreased by the amount of any variations in world prices as expressed by the published prices for cargo lots of gasoline, kerosene, and Diesel oil, respectively, f. o. b. United States ports in the Gulf of Mexico (hereinafter called "Gulf prices"). The method * * * for ascertaining such variations is to determine for each product the difference between the average of the Gulf prices on the second Wednesday of each of the 12 months preceding the 1st of July of each year, and the average of Gulf prices which obtained for that product on the second Wednesday of each of the 12 months preceding the 1st of July 1931 * * *. The published prices for cargo lots of gasoline, kerosene, and Diesel oil, respectively, shall be those published in Platt's Oilgram, a journal of the city of New York, U. S. A., under the heading of "Gulf export market" * * *.[33]

The fact that prices in Iraq were thus linked to United States Gulf prices led to a controversy in 1933 between IPC and the Iraq Government. Following the devaluation of gold in the United States in 1933, export prices of petroleum products increased at the United States Gulf and, in accordance with the formula, prices charged Iraq consumers for petroleum products were also increased. The Iraq Government immediately protested, insisting that the high prices were causing undue hardship and that it was not equitable for Iraq consumers to have to pay prices which they considered higher than the prices being charged for the same products in other parts of the world.[34] The Iraq Government asked that there be an alteration in the formula for computing local petroleum product prices, but IPC was unwilling to consider such a modification without regard to other changes in the agreement.

Apparently consumers in Iraq continued to be charged prices based upon quotations at the United States Gulf, regardless of the facts that (*a*) the crude is produced in Iraq, (*b*) it is produced at low cost, (*c*) it is refined in a nearby refinery, and (*d*) the products are marketed by a local company.[35]

Financial results of IPC.—Although data on the financial operations of IPC are fragmentary, those that are available indicate that IPC was a highly profitable venture. In February 1937 Standard Oil Co. (New Jersey) estimated that its properties in the red-line area were worth between $119,000,000 and $143,000,000, exclusive of the value of the Basrah concession, the discovery of light oil in the BOD (Mosul) concession, and the discovery of oil at Qatar. This is to be compared with a total investment by Standard Oil Co. (New Jersey) of approximately $13,940,000 in the red line area at the end of 1939.[36] Thus, for every dollar of investment Jersey Standard had obtained about $10 of capital value.

The profits realized from Iraq crude were also satisfactory. Standard Oil Co. (New Jersey) realized an average profit of about 52 cents per barrel on its share of Iraq crude (produced and purchased) over

[33] Memorandum from J. Skliros to the groups, February 28, 1935. In a draft of the Iraq Convention dated October 10, 1930, there is a specific example of how the above-indicated formula was actually worked out.

[34] Minutes of meeting of directors of IPC, July 10, 1933. For a further discussion of pricing practices and methods see ch. X.

[35] Since 1932 the local marketing of petroleum products in Iraq has been entrusted to the Rafidain Oil Co., Ltd. (a subsidiary of the Khanaqin Oil Co., itself a subsidiary of the Anglo-Iranian Oil Co., Ltd.) by agreement between IPC and the Anglo-Iranian Oil Co., Iraq Petroleum Co., Ltd., and associated companies, op. cit., p. 71.

[36] Letter from Eugene Holman to W. E. Pratt, March 18, 1940, and attached report Review of Iraq Petroleum Co. Ltd., submitted by R. P. Bolton, March 5, 1940, to Eugene Holman.

the period 1934–39—more than double the approximate 25 cents per barrel paid to the Iraq Government in 1938 for royalty and taxes.[37]

To the end of 1937 total profits earned on sales of Iraq crude by Standard Oil Co. (New Jersey), through its subsidiary Standard Oil Co. of New Jersey amounted to $10,400,000, while total investment at the end of 1939 was only $13,940,000. At the 1938 rate of profits it would have taken only about one more year of operation for Standard Oil Co. (New Jersey) to have recouped its total investment in IPC.[38]

Although the above data relate to only one company and cover only the early years of IPC's operations, there is no reason to believe that the operations of the other owners of IPC were less profitable than those of Standard Oil Co. (New Jersey). A Standard Oil Co. (New Jersey) official stated in 1940:

> If the Iraq pipe line capacity is increased, Jersey's profits should increase at a corresponding rate, assuming that other factors remain the same * * *.[39]

WORLD WAR II AND POSTWAR DEVELOPMENTS

After the outbreak of World War II in 1939, it became increasingly difficult for IPC to continue its operations. Its activities were upset by the normal disruptions of the war such as the sabotage of pipelines, the rebellion in Iraq in 1941 and the subsequent occupation of Iraq by British troops, the negotiations of moratoriums on concession agreements with Iraq and other governments, the inability to carry out pipeline expansion plans, and so forth. But these disruptions had little direct bearing upon the problems which are of central interest in this report.

What is important from the point of view of this report was the disruption of the red line agreement and the subsequent maneuvers and improvisations of the groups. CFP and Gulbenkian were declared enemies and could not participate in IPC affairs; NEDC claimed the war dissolved the red-line agreement but CFP and Gulbenkian denied this was so; CFP took the matter to court when Jersey Standard and Socony refused to permit any group to have a share in Standard and Socony's interest in Arabian American Oil Co., and, after 2 years of negotiation but before the court action came to trial, the groups concurred on a new agreement eliminating most of the restrictive provisions of the red-line agreement. These are the principal issues upon which attention will be focused in this section.

Effects of war upon IPC operations

Shipments disrupted.—Shortly after the outbreak of war in 1939, the British and French Governments, which possessed mandatory powers over Palestine and Syria, respectively, prohibited shipments from Haifa and Tripoli (IPC's Mediterranean terminals) to destinations outside the British and French Empires. But this restriction did not result in any reduction in IPC production, for the British and French required all possible oil from this source. However, with the entry of Italy into the war in June 1940, the Mediterranean was closed to Allied shipping and it was impossible to export

[37] Ibid.
[38] Ibid. In 1938, producing costs in Iraq averaged about 32.7 cents per barrel, of which approximately 25 cents was in the form of royalty and tax payments to the Iraq Government. It should be noted that the 1938 producing costs were also somewhat higher than the costs of prior years.
[39] Ibid.

from Haifa and Tripoli. From that time on until the Mediterranean was opened to Allied shipping, IPC could produce only such oil as could be processed locally at the refineries at Haifa and Tripoli.[40]

In 1939, Consolidated Refineries, Ltd., a company owned 50–50 by Anglo-Iranian and Royal Dutch-Shell, constructed a refinery at Haifa and in 1940 the French High Commissioner of Syria constructed a small refinery at Tripoli. Under an agreement with IPC, the French High Commissioner was to own and operate the Tripoli refinery during hostilities but it was to be turned back to IPC at the end of the war and the crude which IPC agreed to supply was to be considered as payment for the refinery. Until the Mediterranean was freed for allied shipping, the Haifa and Tripoli refineries were the only outlets for Iraq crude, and consequently production during this period was sharply curtailed.[41]

(2) *Red-line arrangement for sharing crude is frustrated.*—By disrupting shipments the war prevented the groups from taking their proportionate shares of crude under the red-line agreement. When the Mediterranean was closed to Allied shipping, Standard Oil Co. (New Jersey) could no longer send tankers to lift crude or products at Haifa or Tripoli. For a considerable period during the war, CFP and Gulbenkian also were unable to take their proportionate shares of IPC's production. When the French capitulated to the German army in July 1940 the British Government ruled that French companies and persons residing in Occupied France were enemy aliens, and since CFP and Gulbenkian[42] both fell within this category, it was illegal for the groups in IPC even to communicate with these enemy groups. Orders were issued vesting the rights of CFP and Gulbenkian in IPC in the British Custodian of Enemy Property. Gulbenkian's enemy status was revoked in 1943 and CFP's in 1945; but during their periods of enemy status neither of these groups could receive any return from IPC operations, Socony-Vacuum, however, executed an agreement with Consolidated Refineries, Ltd., on June 30, 1939, for a throughput privilege equivalent to 15 percent of the capacity of the Haifa refinery. This enabled Socony to continue to take refined products derived from Iraq crude.[43] Thus, there was a period when the only groups who could share in Iraq's production were Anglo-Iranian, Royal Dutch-Shell and Socony-Vacuum.

(3) *Ad hoc arrangements in lieu of red-line agreement.*—With Gulbenkian's and CFP's interests in the hands of the British custodian, it was clear that the red-line agreement could not be fully effective, particularly the provisions relating to pricing and sharing of crude (clause 13). After consulting English counsel and the custodian of enemy property, it was decided that Iraq crude would be sold at a reasonable price to such groups as could take it, and crude would be produced to the extent that the groups were able to take delivery.[44]

This ad hoc arrangement was called a supplemental group agreement; but in order to give substance to the agreement, the groups had

[40] Summary of IPC operations, and notes on Iraq Petroleum Co., Ltd., and affiliated companies.
[41] Ibid.
[42] Although Gulbenkian's company was registered in Canada, and he was an English citizen and claimed diplomatic immunity as commercial attaché to Iranian Legation in Paris, he was still considered an enemy alien under the order. The groups had last heard from Gulbenkian on June 16, 1940 from Vichy. He left France in April 1942 and took up residence in Lisbon, Portugal, and in July 1943 was declared to be no longer an enemy alien.
[43] Agreement between Socony-Vacuum Oil Co., Inc., and Consolidated Refineries, Ltd., June 30, 1939, exhibit No. 23.
[44] Minutes of group meeting, October 2, 1940, October 17, 1940, October 31, 1940, March 20, 1941, et al.

to come to some decision with respect to what was a fair and reasonable price for Iraq crude. This question was temporarily resolved by an agreement that for the period October 17, 1940, to March 31, 1941, Iraq crude would be sold to the groups, f. o. b. or delivered at the Haifa refinery, at the free market price for east Texas crude f. o. b. United States Gulf, less a differential for quality of 24 United States cents per United States barrel.[45] An American oil broker, Mr. Riddell, was selected by the groups to ascertain, certify, and report the month-by-month average price of east Texas crude.[46] In the language of the trade this price, which reflected the United States Gulf price, came to be called the "Riddell price."

As has been noted, under the red-line agreement the practice had been to base the price for Iraq crude, not on the United States Gulf price, but on United Kingdom income tax cost, plus 1 shilling per ton profit. However, during the year 1940 when production of crude was curtailed because of shipping restrictions, the cost of production and transportation of Iraq crude increased to such an extent that costs exceeded the world market price, with IPC for a time operating at a loss. It was then decided, as a general principle, to sell Iraq crude to the groups at the world market price, i. e., the "Riddell price," or at the United Kingdom income tax cost price plus 1 shilling per ton profit, whichever was lower.

At first glance it would appear that this new arrangement would have had no direct effect whatever upon the price question. Since at the time the "Riddell" or Gulf price was well below the income tax price, the groups under the compromise would have been required to continue using the Gulf price. Presumably this would have meant that instead of being able to use a price which at least covered IPC's costs (the United Kingdom income tax cost price), they would have to continue using a price on the basis of which the IPC was losing money.

But it should be remembered that the British and American members had long followed a policy of making their profits from Iraq oil, not from the operations of IPC itself, but from the margin or difference between, on one hand, the cost to them of the Iraq crude and on the other the price which they could secure on their sales of refined products. Thus, a low price for Iraq crude, while resulting in losses to IPC itself, was in the traditional policy of the British and American groups.

The effect of this new arrangement was to bring about a low price for Iraq crude under all conditions. During periods of reduced output, when IPC's costs were high, it could be expected that the Gulf price would be below the United Kingdom income tax price, that it would thus govern the IPC price, and that the British-American groups would be able to secure the Iraq crude at a low price. Conversely, when Iraq production was high and its costs were low, it could be expected that the United Kingdom income tax price (which was essentially a "cost-plus" formula price) would be lower than the Gulf price, thus again assuring the British-American groups of Iraq crude at a low price.

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[45] Minutes of group meeting, October 17, 1940, October 31, 1940; cable from H. G. Seidel to Near East Development Corp., October 17, 1940; and memorandums from J. Skliros to the groups, November 14, 1940, and December 14, 1940.

[46] Minutes of group meeting, November 21, 1940.

In March 1942, the general manager of IPC reported to the groups that "Mr. Riddell had reported the present conditions in the United States of America must be expected to restrict the free movement of east Texas crude and in the circumstances the f. o. b. differential could not be reliably indicated. He, Mr. Skliros, would, therefore, record the last reported f. o. b. figures of 21½ cents per barrel until such time as Mr. Riddell reported a change." From minutes of group meeting, March 19, 1942.

As would be expected, the French (CFP) and Gulbenkian, who had traditionally sought to obtain their profits from the direct operation of IPC itself, rather than from the margin between Iraq crude and refined products prices, objected violently through their agents to this new arrangement. In their opposition, they were joined by the British Custodian of Enemy Property. These three parties were all agreed that the pricing formula worked to the disadvantage of CFP and Gulbenkian.[47] They contended that the general principle of pricing on the basis of the world market price or United Kingdom income-tax cost plus 1 shilling per ton profit, whichever was less, meant that in the years when production increased, and costs reduced, the groups that could take crude would buy at United Kingdom income-tax cost price and thereby benefit; but when production was low, as it was in 1940–41, crude would be sold at the world market price (Riddell price) and any IPC losses resulting therefrom would be shared by all groups regardless of whether they were able to take crude and share in the benefits. The Custodian did not believe that when the group agreement was signed the groups contemplated that the benefits of cheap oil should accrue to some at the expense of others, and the fact that the trading losses of IPC in 1940 were carried over into 1941 brought forth caustic remarks and complaints from the Custodian.

As would be expected, the British and American groups rejected the view of the Custodian. But, in order to satisfy him and the agents of CFP and Gulbenkian, the British-American groups agreed to pay an additional price or surcharge above the regularly established price so that at the end of 1941 the loss incurred in 1940 would be wiped out. Apparently, calculations under the Riddell or Gulf price formula were reported over a period of several years.[48] However, it was the governing price only for the years 1940–41, when IPC production was drastically curtailed. In subsequent years, production was large enough that a price based on United Kingdom income-tax cost plus 1 shilling profit was below the Gulf market price, and therefore governed IPC operations.

Postwar settlement

CFP and Gulbenkian reinstated in IPC and war claims settled.—In July 1943, Gulbenkian's rights as a shareholder in IPC were restored by the Custodian of Enemy Property, and Gulbenkian resumed his position as a director of IPC with the right to receive his proportionate share of Iraq crude and products. There arose immediately the problem of settling with Gulbenkian for the crude and products which he had been unable to lift. Gulbenkian denied that he had ever been

[47] Memorandum by Mr. Piesso to David Shepard dated April 21, 1944, and minutes of group meeting, November 20, 1941.

[48] Minutes of group meetings, December 18, 1941, January 15 and 29, 1942, and November 12, 1942. The Mechanics of the "Riddell formula" are shown by the following statement taken from a letter dated July 12, 1944, from H. E. W. Kirby, Anglo-Iranian Oil Co., Ltd., to Mr. Taylor of the same company:

"I am writing you to confirm my advice to you by telephone of the information we have received from New York in reply to our request that Riddell be asked to inform us regarding a fair price for East Texas crude f. o. b. the Gulf, and of his views as to the value, based on Gulf export prices, of the benzine which from time to time has been added to stabilize crude delivered to the Haifa Refinery.

"As regards crude oil, Riddell's advice is that he has made no f. o. b. Gulf sales of East Texas crude since December 1941; but that, as OPA ceiling prices became effective in February 1942 and crude sales are more or less under PBW allocations, he considers that any sales made during the periods with which we are concerned would have been at posted field price plus full tariffs. As you know, during these periods the posted field price of East Texas crude remained constant at $1.25 per barrel; and by the addition of 17½ cents, representing the full tariff rates for gathering pipeline and handling charges less the quantity differential on the 'Riddell formula' of 24 cents per barrel, the resultant price per ton of IPC crude worked out at 44s. 8d."

an enemy, strongly maintaining that his position was very different from that of CFP.[48]

Various proposals and counterproposals were passed back and forth between Gulbenkian and the other groups in IPC regarding the compensation which Gulbenkian should receive. For a time, it appeared that Gulbenkian might resort to litigation, but eventually on May 23, 1945, Anglo-Iranian, Shell, and NEDC settled Gulbenkian's war claims by paying him £547,000.[49] In consideration of this payment, Gulbenkian released the groups from all claims arising out of or in connection with any acts concerning crude oil or products produced in the red-line area up to February 9, 1945.[50]

The American member's (NEDC) share of the lump-sum settlement was 103,498 pounds sterling and was paid by Jersey Standard and Socony in proportions agreed upon between them.[51]

CFP was not reinstated into the good graces of IPC until February 1945.[52] Like Gulbenkian, it also presented claims against the groups for compensation for the crude and products which CFP was unable to take during the period of its enemy status. CFP vigorously and continuously pressed its claim, contending that the groups who were in a position to take crude during the war profited at the expense of CFP because IPC's profits were either nonexistent (when the Gulf price governed ICP's price) or only nominal, i. e., 1 shilling per ton (when the United Kingdom income-tax price governed IPC's price). Yet at the time, the British-American groups were making large profits from their marketing and refining organizations by purchasing crude at a low price and selling their refined products at a relatively high price.[53] In 1946, CFP presented a claim against NEDC, Shell, and Anglo-Iranian for 2,425,000 pounds sterling.[54] The British-American groups replied by stating there was no legal basis for CFP's claim.[55]

Although CFP continued to press the matter, no settlement had been reached by November 1948 at which time it was agreed that the CFP claims should be submitted to arbitration.[57] However, the companies concerned could not agree on a form of submission to arbitration, and CFP threatened to take the matter to court. A settlement was finally reached through negotiation in February 1950 with Shell, Anglo-Iranian, and NEDC agreeing to pay CFP £500,000.

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[48] In support of this view, Gulbenkian stated that while he was in Paris and Vichy he was Commercial Counselor to the Iran Government and enjoyed full diplomatic immunity, both before and after the fall of France. It was not until Iran broke off diplomatic relations with the Axis Powers that he was asked to leave France. Memorandum from M. Piesse to S. Morgan, August 31, 1944.

[49] Apparently, Gulbenkian was not informed of the basis for settlement. A cable from Richard Sellers and David Shepard to NEDC, May 10, 1945, reads as follows:

"* * * the three major groups concerned have agreed with Gulbenkian for a settlement of all his claims of whatever nature up until the 9th of February 1945 for a cash payment of £547,000, upon payment of which he and P and I will release IPC and the three groups from all claims up to that date. The method by which we have arrived at this sum is not being disclosed to Gulbenkian, but we have arrived at this round figure by taking the difference between the amount paid by the groups to IPC and the MacDonald price on 5 percent of all deliveries made to Haifa refinery from April 7, 1943, the date when Gulbenkian lost his enemy status, to the 9th of February 1945, the date when CFP regained their nonenemy status, and considered also the fact that under the sale-of-oil agreement between CFP and Gulbenkian the latter was entitled to 10 percent interest on overdue payments."

[50] Copy of Gulbenkian settlement agreement attached to memorandum from Stuart Morgan to E. L. Estabrook and M. Goddard, July 11, 1945.

[51] Memorandum from Near East Development Co. to R. W. Sellers, May 15, 1945.

[52] Copy of Order of the Board of Trade revoking the orders vesting in the Custodian of Enemy Property CFP's rights in IPC dated February 9, 1945.

[53] Claim by CFP, a memorandum attached to letter from David Shepard to Stuart Morgan, August 1, 1945.

[54] Memorandum prepared by CFP on Claims for Compensation, August 1, 1946.

[55] It appears that the French Government realized that CFP had no legal basis for its claim. In its appeal to the British Foreign Office for assistance in the CFP matter, the French Government indicated that it wished to support CFP's claim for compensation for loss of profits during the war on the grounds of general equity. Letter from F. R. Hoyer Miller, British Foreign Office, to J. Skliros, August 22, 1946.

[57] The heads of agreement of November 3, 1948, provided that the CFP claim should be submitted to arbitration. This agreement will be discussed in more detail in subsequent sections.

In general, the CFP payment was made by the groups on the basis of the takings, by each group, of oil which might have come from the French share during the period between the liberation of Paris and the restoration of the CFP's rights in February 1945.[58] Insofar as NEDC was concerned, the major part of the CFP payment was made by Socony-Vacuum because it had been able to lift crude at a time when Standard Oil Co. (New Jersey) was unable to do so. Standard Oil Co. of New Jersey's part of the settlement amounted to only £1,170.[59]

The American group declare the red-line agreement dissolved.—In October 1946, the American group, acting individually through Standard of New Jersey and Socony-Vacuum and collectively through NEDC, declared the red-line agreement to be dissolved. This was not an abrupt and spontaneous decision, but was arrived at in a series of progressive steps.

In 1941, when the groups were discussing with the British Custodian of Enemy Property the question of whether or not the group agreement should remain in effect, they concluded after consulting legal counsel, that the group agreement should remain in full force and effect except for the provision relating to the sharing of oil. It is to be noted that at that time NEDC took no exception to the validity of the group agreement.[60] But in 1945, after CFP and Gulbenkian had been reinstated in IPC, the American group's position with respect to the validity of the red-line agreement became somewhat uncertain. In fact, NEDC was "not convinced that action should be taken on reaffirmation of the group agreement but they did consider it important that offers of oil under the agreement should be resumed immediately." [61]

In October 1945, NEDC notified the groups that it would not admit an obligation to report any red-line purchase of products, but only crude.[62] It will be recalled that under the red-line agreement the groups were clearly prohibited from making independent purchases of crude within the red-line area. But the question of whether or not the red-line agreement prohibited the purchase of products derived from crude produced within the red-line area was by no means clear.[63]

Why this complete reversal of position regarding the red line between 1941 and 1945? Standard of New Jersey had an explanation. In 1946, the president of CFP visited the United States, and among other things discussed with Jersey Standard CFP's claim for compensation for oil which CFP had been unable to lift during the war. At that time, Standard advised CFP that it had refused to reaffirm the red-line agreement. In indicating the reason for its position, Mr. Holman, president of Standard Oil Co (New Jersey), stated that:

> *There had been a substantial change in the attitude of the American public and Government toward restrictive agreements and, under current conditions, reaffirmation of the agreement seemed inadvisable.*[64]

[58] French war claim release appended to letter from Charles F. Darlington to NEDC, February 15, 1950

[59] Executive committee minutes, Standard Oil Co. (New Jersey), February 17, 1950.

[60] Letter from M. Piesse to Stuart Morgan, June 30, 1941.

[61] Notes on group meeting, September 13, 1945.

[62] Letter from D. A. Shepard to E. E. Soubry, January 2, 1946.

[63] In 1945, NEDC's representative on IPC obtained an opinion from English counsel which stated that purchases of products within the red-line area were not prohibited by the red-line agreement. NEDC then asked Shell to obtain corresponding opinion from another English counsel on the same question. Shell obtained such an opinion and since both opinions were to the effect that purchases within the red line were not prohibited, Standard was then in a position to notify the groups that it was under no obligation to report the purchase of products made within the red-line area. From letters, cables, and memoranda regarding this subject.

[64] Memorandum of conversation as reported by Mr. Holman with Messrs. de Metz and van den Perre January 29, 1946. [Italic added.]

In response to a question as to why Standard was now taking the position that purchases of petroleum products within the red-line area were permitted by the red-line agreement, Mr. Holman stated that:

> The question had not arisen before as such purchases were not necessary. However, as there had been a substantial change as a result of the war, the need now exists and it is for this reason that Jersey has requested legal opinion as to its rights under the agreement to make such purchases.[65]

In point of fact, the question of the rights of the groups to make purchases of products within the red-line area had previously arisen. The record indicates that this question was discussed at length by all the groups before the war, particularly in regard to the efforts to obtain an agreement with Standard Oil Co. of California with respect to the purchase of Bahrein petroleum. It is difficult to escape the conclusion that Jersey Standard was preparing a legal basis for defending the agreement which Jersey Standard and Socony-Vacuum were then trying to make with Standard Oil Co. of California and the Texas Co. for the purchase of a share interest in Arabian American Oil Co.'s (Aramco) concession in Saudi Arabia.

This interpretation by NEDC of the red-line agreement and the failure of the groups to report purchases made in the red-line area became matters of great concern to Gulbenkian and CFP. In May 1946, Gulbenkian suggested that the matter should be brought into the open at an appropriate meeting.[66] In response to Gulbenkian's demands, NEDC stated it had been advised by English counsel that the prohibition in the group agreement to purchases within the red line applied only to crude and not to refined products.[67] CFP viewed NEDC's position as being an entirely new and unofficial one which had never been previously advanced, even though the problem had been discussed for more than 2 years.[68] Shell and Anglo-Iranian also believed the groups should abide by the red line, but they never vigorously contested NEDC's position.[69]

The American group, however, was anxious to expand in the Middle East and was not easily deterred. Armed with substantial legal support that some parts of the red-line agreement were no longer legally binding, Jersey Standard and Socony (the NEDC owners) began negotiations with Standard Oil Co. of California and the Texas Co. for an interest in Aramco's concession in Saudi Arabia. Although an agreement in principle was not reached until December 1946, the executive committee of Jersey Standard concluded 5 months earlier that the red-line agreement was dissolved and that the other groups in IPC should be so informed.[70] Formal notices to the effect that Standard Oil Co. (New Jersey), Socony-Vacuum Oil Co., Inc., and Near East Development Corp. considered the group agreement

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[65] Ibid. It is not without interest that although Standard Oil Co. (New Jersey) was unable to lift its share of Iraq crude during the war, it did no more than advise IPC that it had been penalized with respect to crude deliveries during the war and that it reserved all rights. The fact that Standard presented no formal claim for compensation would appear to be an indication that it considered the red-line agreement as no longer valid and as insufficient legal basis for presenting a claim. Letter from Dave Shepard and R. W. Sellers to the directors of IPC, Anglo-Saxon Petroleum Co., Ltd., D'Arcy Exploration Co., Ltd., Compagnie Francaise de Petroles (CFP), and Participations & Investments, Ltd., November 20, 1945.

[66] Notes on board and group meeting, May 9, 1946.

[67] Minutes of group meeting, May 9, 1946.

[68] Draft of minutes of group meeting prepared by E. J. Brown, May 9, 1946.

[69] In July 1945, the president of Standard Oil Co. (New Jersey) had discussions in England with the heads of Anglo-Iranian and Royal Dutch-Shell concerning the red-line agreement and possible changes in Standard's interest in the Middle East, and at that time the two English groups believed they should follow the red line. Executive committee minutes, Standard Oil Co. (New Jersey), July 5 and August 1, 1945.

[70] Executive committee minutes, Standard Oil Co. (New Jersey), May 28 and August 6, 1946.

dissloved were drafted as of October 3, 1946, and were delivered to the other IPC groups in December 1946.[71]

CFP takes the matter to court.—CFP and Gulbenkian denied that the red-line agreement was dissolved and counsel for these groups lost no time in protesting the American group's action. In November 1946, Gulbenkian's counsel informed NEDC's legal representative on IPC (M. Piesse and Sons) that he disagreed with the American group's position and that their actions seriously threatened the interests of Gulbenkian. He stated, however, that no member of the group desired litigation "which would necessarily disclose to the world a divided front and open up the affairs of the group to public discussion," and that Gulbenkian would endeavor to formulate a friendly arrangement affording protection for his legitimate interests.[72]

CFP, likewise, did not agree with the position taken by the American group. In December 1946, Standard (New Jersey) and Socony had reached an agreement in principle with Standard of California and the Texas Co., and notices to that effect had been reported in the press. Attorneys for CFP immediately notified the legal representatives of the American group that if the press reports concerning these negotiations were true, the transaction resulting from such negotiations would constitute a breach of the red-line agreement.[73] CFP's attorneys further advised that unless they had assurances that the press reports were erroneous and that Standard and Socony had not purchased an interest in Arabian American Oil Co. (Aramco), it would be necessary for CFP to take immediate steps to protect its interests under the red-line agreement.[74] They also accused the American group of using the Sherman Act as an "excuse upon which to hang" the breach of the "red line" resulting from the Aramco deal.[75]

But CFP did not resort to court action as their first counter move. In their notice of dissolution of the red line agreement, Standard, Socony, and NEDC had indicated that although some of the provisions of the red-line agreement, particularly the restrictive provisions, were inappropriate, they were desirous of negotiating the terms of a new agreement which would exclude the restrictive clauses. The groups took hope from this statement and engaged in discussions for several months regarding various aspects of a new agreement. CFP and Gulbenkian, however, wanted a share of any interest which the American group obtained in Aramco—a concession which the American group refused to make. In January 1947, Standard and Socony officially advised the CFP that they could not agree to give CFP or any of the IPC partners a participation in the Arabian-American arrangements.[75] Shortly thereafter, in February 1947,

[71] Copy of unsigned letter to Sir Francis Humphries, chairman of IPC, October 4, 1946, and the executive committee minutes, Standard Oil Co. (New Jersey), December 9, 1946.
[72] Copy of letter from Freshfields to Piesse & Sons, November 11, 1946.
[73] Letter from Denton, Hall, and Burgin to Messrs. Piesse & Sons, December 20, 1946.
[74] Ibid.
[75] On January 7, 1947, the attorneys for CFP wrote to Messrs. Piesse & Sons, counselors for NEDC as follows:

"We agree that in oral conversations since September last your clients have indicated that for reasons of domestic policy and particularly the probable consequences of the Sherman Act they have had to consider the legal question of the consequences of war on the group agreement, and that they had received certain advice from English counsel consulted. That advice we were never able to concur in by reason of the advice we ourselves had received, but so long as the matter remained one merely of difference in juridical opinion and the group agreement in fact was operated, we were content to leave it on the plane of academic discussion.

"Matters, however, have now changed. It would appear that the Sherman Act no longer is the real course (cause?) of concern, but was merely an excuse upon which to hang a contemplated and now effected breach of the group agreement, namely, the negotiations leading up to your client's proposed acquisition of a large interest in Caltex."

From letter from Denton, Hall, and Burgin to Messrs. Piesse & Sons, January 7, 1947.

CFP brought suit in the British courts against NEDC and the other groups in IPC. In this action, CFP sought a declaration that the 1928 group agreement was valid, that NEDC, Standard Oil Co. (New Jersey), and Socony-Vacuum were not free to obtain or be interested in any oil concession in the red-line area or in the purchase of any such oil otherwise than through IPC, and that any interest which NEDC, Standard, or Socony obtained in Aramco should be held in trust for the benefit of the other groups of IPC. In addition, CFP asked for an injunction restraining NEDC, Standard, and Socony from acting otherwise than through IPC.[76] Gulbenkian supported CFP's action as both were demanding some type of compensation for the alleged breach of the red-line agreement.[77]

NEDC files a counter suit.—Jersey Standard and Socony-Vacuum, joint owners of NEDC, filed a statement of claim with the British High Court of Justice in June 1947 denying many of the allegations made by CFP. CFP's suit, supported by Gulbenkian, had alleged that an acquisition by NEDC of an interest in Arabian American Oil Co. would constitute a breach of the group agreement and/or the declaration at the end of the group agreement. NEDC, in its statement, countered this allegation by saying that:

> * * * *any agreement contained in the said declaration was in restraint of trade and contrary to public policy and void and unenforcible in law.*[78]

Thus, Standard and Socony followed the red-line agreement for almost 20 years without making any serious objections, but when they wished to obtain an interest in Aramco, they described the agreement as one:

> * * * in restraint of trade and contrary to public policy and void and unenforcible in law.

The president of Jersey Standard explained his company's position in 1946 when he stated that:

> There had been a substantial change in the attitude of the American public and Government toward restrictive agreements and under current conditions, reaffirmation of the agreement seemed inadvisable.[79]

On the other hand, it may be recalled that CFP's attorney had in effect accused the American group of using the Sherman Act as a ruse to get into Aramco.[80]

Revised agreement negotiated and court actions withdrawn.—Irrespective of the court suits, relations were not so strained as to preclude the groups from continuing their discussion concerning a new agreement. None of the groups was desirous of having IPC's affairs aired in court. Hence, they earnestly endeavored to come to an agreement before the court suits came up for trial.

The negotiations were long and arduous, lasting almost 2 years.[81]

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[76] Letter from Dave Shepard to Orville Harden, January 27, 1947.

[77] Standard Oil Co. (New Jersey) executive committee minutes, January 9, 1947; prospectus issued by Standard Oil Co. (New Jersey), June 11, 1948, pp. 29–30, and various copies of documents relating to CFP's suit and counter claims.

[78] Statement of Claim filed in High Court of Justice, Chancery Division, June 9, 1947. [Italic added.]

[79] See p. 262.

[80] See p. 267.

[81] The four major groups (Anglo-Iranian, Shell, NEDC, and CFP) had reached a tentative agreement in May 1947 but they had to negotiate a year and a half longer (until November 1948) before they could come to an agreement with Gulbenkian. At one time the groups were on the verge of signing a four-party agreement and leaving Gulbenkian the choice of either signing with them or pursuing his case in court, but no one wanted IPC's troubles aired in court as long as there was any chance for a negotiated settlement. A high official of Standard Oil Co. (New Jersey) visited Gulbenkian in Lisbon in September 1947 and smoothed the way for further negotiations.

The principals had divergent interests and were represented by numerous counsel. Gulbenkian wanted compensation for the proposed Aramco arrangement (which he considered to be a breach of the red line), adequate protection of his interests, and since he had no refining or marketing facilities, an assured market for his oil. CFP sought a settlement of its war claims, i. e., compensation for oil not lifted during its period of enemy status, and a more rapid development of IPC, including more production, pipelines, and facilities. Anglo-Iranian wanted assurances that its 7½ percent royalty would be continued and a slow expansion of IPC's production. Shell approved of some expansion of IPC's operations, but wanted it done in an orderly manner. NEDC's principal interests were to exclude the restrictive clauses in the red-line agreement, get the other groups to agree that NEDC's acquisition of an interest in Aramco would not be a breach of contract, and induce CFP to discontinue its court action.

The various interests and divergent views of the groups were reconciled to the extent that a new agreement, called Heads of Agreement and Supplemental Documents, was signed on November 3, 1948.[82] The agreement was a combination of several separate documents, prepared at different times, some before World War II, plus last minute telegrams and letters. These documents have been described by one who was intimately familiar with their development as being "in some respects monuments of complexity." [83] A summary of the major aspects of the agreement follows:

The red-line agreement was canceled and all claims arising out of it were waived.[84] In what was termed the "Aramco Release," [85] CFP was to withdraw its court suit (NEDC also was to discontinue its counter action) and Standard and Socony were free to complete their acquisition of an interest in Aramco.[86]

The new agreement went a long way toward removing some of the most obvious restrictive provisions of the red-line agreement which limited the freedom of a group member to obtain concessions, purchase crude and products, and engage in refining and marketing operations within the red-line area. The restrictive provisions relating to these operations were specifically excluded from the new agreement.[87] A group could now acquire rights in the red-line area without being under obligation to share proportionately with the other groups. From the point of view of the American companies, this right to be free either to participate or stay out of any joint venture proposed by a group member was a considerable improvement over the forced sharing provisions of the red-line agreement.

Anglo-Iranian retained its right to a 7½ percent royalty on all crude oil produced from the area included in the Iraq concession on May 1, 1934. The new agreement merely restated the royalty arrangement that had existed before.

[82] This agreement has no relation whatsoever to the Heads of Agreement for Distribution, 1932, which is discussed in chapter VIII.

[83] Memorandum regarding IPC Group Agreement—Restrictive Provisions in Original Agreement Which Have Now Been Removed.

[84] Memorandum regarding Heads of Agreement dated November 10, 1948.

[85] Heads of Agreement and Supplemental Documents, p. 45.

[86] Standard and Socony had made an arrangement in March 1947 for an interest in Aramco which was contingent upon the suits in the British court being settled by March 12, 1951, or if prior to that date, the litigation was determined adversely to Standard and Socony, the agreement was terminated. Thus, the Aramco release removed all obstacles to the Standard-Socony-Aramco deal. Standard Oil Co. (New Jersey) prospectus June 11, 1948, p. 25.

[87] Memorandum regarding Heads of Agreement, op. cit.

Under the new agreement, CFP's war claim was to be submitted to arbitration. Also of interest to CFP was the agreement to expand IPC's operations.[88] The groups agreed to provide the necessary additional facilities, especially pipelines, to expand the production of Iraq oil in conformance with a planned program. For the period 1952–56, each group nominated its oil requirements and these were included in schedule B in the heads of agreement. Program requirements were to be set out by 5-year periods, and were to be prepared 5 years before the commencement of the period, i. e., in 1952 the program for the period 1957–61 must be prepared. In the formulation of programs, each group nominates its own requirements and these may be more or less than its basic share proportion, i. e., the share of oil proportionate to a group's stock ownership in the venture, but there are maximum limits to the amount of oil a group can take in any one year. All oil produced is to be offered at the United Kingdom income tax cost-plus-a-shilling price to the owning groups in accordance with their share proportions, but if a group indicates program requirements smaller than its basic proportion, then it is required to sell to those having program requirements in excess of their basic proportions. These sales are to be made at a price in sterling halfway (called "half-way" price) between the cost-plus-a-shilling price and the current world market price.[89]

There were special provisions in the new agreement affecting Gulbenkian (called P and I in the agreements, abbreviation for Participations and Investments, Ltd.). During the period 1952–66, in lieu of his right to receive oil in excess of his basic proportion, Gulbenkian is entitled to receive 3,750,000 tons of what is called special allocation oil. Delivery of this oil will begin either on January 1, 1952, or on the date when deliveries of oil through the big-inch pipeline to the Mediterranean commence, whichever date is later.[90] Gulbenkian will purchase 5 percent of this oil, i. e., his basic proportion, from IPC and group companies at the cost-plus-a-shilling price and the balance (called "special over requirement" oil) at the "halfway" price. After 1966, Gulbenkian's position as regards programing and his right to receive oil will be the same as any other group, subject only to the limitation of his 5 percent share ownership.[91]

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[88] CFP's demands for an expansion of IPC production raised some interesting problems for the major groups with large refining and marketing interests in France. The nature of these problems and one official's view as to what the solutions should be are revealed in a letter dated March 26, 1947, from R. Andre, an official of Standard Francaise des Petroles (a Standard of New Jersey subsidiary which operates in France), to Orville Harden of Standard (New Jersey). Mr. Harden at that time was in London negotiating with CFP and other IPC groups regarding the new agreement. Mr. Andre had received information about CFP's position, and he was passing this on to Mr. Harden along with his own impressions of the situation. Mr. Andre wrote as follows:

"* * * *it is my feeling that the establishment of a connection between the level to which the Iraq production will be brought and the outlet of CFP in France should be avoided*, as this is a point on which CFP will be very touchy. As mentioned above, *the CFP people feel they are entitled to dispose of their share of wealth and they do not consider it possible to be excluded from taking rank among the international companies and from being able to sell outside continental France part of the production of their refineries*. This is one of the reasons why CFP are endeavoring to augment the volume of their refineries, *considering this policy cannot be interpreted as constituting any danger to the position of their confreres in France. But they feel it is more advantageous for them to increase the production of their refineries in France than to erect new refineries in other parts of the world, which, in fact, might be more of a danger to international trade.*

"*It appears to us here rather inadvisable to adopt a policy tending to limit CFP strictly to the French market* as, in that case, there would be an increasing tendency on the part of the French Government to protect this outlet by means of arbitrary measures. Such measures could not be applied to any other but the French market and *it seems preferable, in the end, to be faced with a free competition on the part of CFP rather than with a competition supported directly or indirectly by the French Government for the internal market.*" [Italics added.]

[89] Heads of Agreement and Supplemental Documents, op. cit., and memorandum regarding heads of agreement, op. cit.

[90] The groups had agreed to construct a 30 to 32 inch pipeline from Kirkuk to Banias on the Mediterranean. Delivery of pipe for this line began early in 1951 and the entire project is scheduled for completion in 1952. This large line will be in addition to the double 12-inch lines completed in 1934, and the double 16-inch lines which were completed in 1949.

[91] Heads of Agreement, op. cit., and memorandum regarding Heads of Agreement, op. cit.

In general, the groups assured Gulbenkian of an outlet for his oil. Each of the four major groups, agreed to enter into separate contracts whereby each major group would become directly responsible for taking its quóta of Gulbenkian oil. The contract of each major group was considered to be a series of separate contracts in respect of each year.[92] As to his basic proportion of oil (his 5 percent share), Gulbenkian has an option of deciding whether he wants the other groups to buy. The option arises in this manner. In August or September of each year, an expert, using world market prices for the first half of the year as a basis, fixes a price which the groups are to offer Gulbenkian for his oil in the following calendar year. When this offer is made, Gulbenkian has the right to accept or reject the offer but he must treat all groups alike.[93] However, Gulbenkian's "special over requirement" oil (oil in excess of his 5 percent basic proportion), which, of course, will end in 1966, must be sold to the groups. The profit margin on this oil, which is the difference between the "halfway" price (see above), and the expert's price, is to be paid to Gulbenkian in dollars. In addition, all the groups agreed to pay Gulbenkian the expert's price in dollars for his 1949 oil, and Standard and Socony further agreed to pay Gulbenkian dollars for all oil purchased from him up to the time he begins to receive "special allocation oil." [94]

Altogether from the point of view of the American companies, the 1948 agreement was a substantial improvement over the red-line agreement in that many of the restrictions upon individual action were eliminated. It was likewise an improvement from the point of view of CFP, since it could now request production of crude oil to meet its requirements even though this might be in excess of its proportionate share of IPC production. Nevertheless, the groups did not attain complete freedom of action. The limitations upon the disposal of oil have heretofore been noted. In the case of concessions owned by a group company and lost otherwise than by expiration or abandonment, if any group wished to try to recover the concession, then all groups were bound to cooperate for a period not to exceed 5 years in an endeavor to reacquire the concession, with a further extension of not more than 5 years if negotiations were interrupted by war. The parent companies and all their associated companies were bound by this provision. Also, under the new agreement (heads of agreement), IPC and its associated companies could not operate outside the red-line area. Thus, the restrictions on the growth and expansion of the joint venture were retained while, as noted above, most of the restrictions on the individual groups were removed.[95] This would appear to give an advantage to Anglo-Iranian, Shell, Standard, and Socony, who have extensive interests outside the red-line area, over CFP and Gulbenkian whose most important oil interests are the IPC venture.

SOME POSTWAR MANAGEMENT POLICIES AND PROBLEMS

Following the end of World War II, the IPC and its member groups were confronted with a number of problems which necessitated new improvisations and adaptations of its basic policies.

[92] Under the previous agreements, Gulbenkian sold his oil to CFP, which in turn sold one-quarter of the oil to each of the other major groups.
[93] Memorandum regarding heads of agreement, op. cit.
[94] Heads of Agreement, op. cit., p. 49, and memorandum regarding Heads of Agreement, op. cit.
[95] Memorandum regarding IPC group agreement, op. cit.

IPC operates the Tripoli refinery.—As noted previously, the French High Commissioner of Syria constructed a small refinery at Tripoli in 1941, and operated it throughout the war. IPC agreed to purchase the refinery by payment of crude with the understanding that the ownership would revert to Syria Petroleum Co., an IPC associated company, upon termination of the war.[96] But since Syria Petroleum Co. had no refining rights in Lebanon, the plant was taken over by IPC.[97]

When IPC obtained the Tripoli refinery early in 1946, the groups agreed to waive any breach of the red-line agreement that would result from the operations of the plant by IPC.[98] This appears to be the first time that IPC engaged directly in refining and marketing operations, and the price and distribution policies which it adopted are of interest in that they indicate the way in which operations of IPC were made to mesh with the policies and plans of the individual group owners.[99] Moreover, and this is perhaps more important, the price and distribution policies adopted by IPC make it unmistakably clear that the underlying motives and intentions of the IPC groups were to keep prices in line, maintain strict controls over the distribution and marketing of the products of the Tripoli refinery, and, in general, operate in accordance with cartel principles.

IPC's price policy.—After deciding to operate the Tripoli refinery, the first problem which IPC had to solve concerned the prices to be charged for surplus fuel oil and unrefined benzine. A Near East marketing committee made up of representatives of Anglo-Iranian, Shell, CFP, and Socony studied the problem and decided that the surplus production of fuel oil at Tripoli should be sold at the "low" of Platt's Oilgram quotations for C grade fuel oil f. o. b. the United States Gulf, and that a price of 31/2d per ton would be charged without a local freight differential.[1] As for surplus unrefined benzine, it should be sold at the "low" of Platt's Oilgram quotations for 60 octane gasoline f. o. b. the United States Gulf, with a deduction for quality equivalent to one-sixth of the price.[2] Apparently, these were the same prices that were charged by the Haifa refinery, for only a few months before the local managements of Socony and Shell had recommended that the prices at Tripoli be on the same basis as prices at the Haifa refinery.[3] Thus, the price policy of IPC was made to conform to the policies followed by the owning groups' marketing organizations in the Middle East.

Control over distribution.—The specific problem that IPC was confronted with was, to whom should IPC sell its products? To solve this question, the IPC groups agreed in March 1946 that a local committee was to be set up in Cairo, Egypt, consisting of representa-

[96] Notes on Iraq Petroleum Co., Ltd., and affiliated companies.

[97] Notes on group meeting, October 11, 1945, and cable from J. Skliros to Mr. Stuckey, November 23, 1945.

[98] Minutes of group meeting, January 17, 1946. The red-line agreement prohibited IPC from engaging in refining and marketing operations.

[99] During the war, IPC, at the request of the British Government, converted stabilization plants at Kirkuk into a topping plant in order to supply petroleum products to the British Army in Iraq. However, the products were sold to Anglo-Iranian which, in turn, sold them to the military authorities. IPC also supplied some fuel oil to the British Admiralty in 1943 but the oil was first sold to the groups in their basic proportions and the groups then resold it to the Admiralty. Thus, IPC had successfully evaded engaging n refining and marketing until it obtained the Tripoli plant. Notes on IPC and Affiliated Companies.

[1] Notes on group meeting held March 14, 1946, and minutes of group meeting, March 14, 1946.

[2] Ibid.

[3] Notes on group meeting held October 14, 1945.

The Haifa refinery, as noted previously, is owned by Consolidated Refineries, Ltd., which, in turn, is owned 50-50 by Shell and Anglo-Iranian. Socony also had processing rights at the Haifa refinery.

tives of the three marketing companies associated with the groups who, acting as agents for all the groups, would instruct the IPC regarding the distribution of products from the Tripoli refinery.[4] It was also agreed that a committee of group representatives should meet and draft instructions for the Cairo committee.[5]

The instructions drafted were basically rules for allocating the output of the Tripoli refinery.[6] The Cairo committee, which represented the IPC groups was given authority to withhold supplies from any marketer. This enabled the committee to exercise complete control over the prices charged. In the form letter which the committee was to send to the refinery manager at the beginning of each quarter, the names of the local marketers, a description of the product, the quantity, and the price to be charged were all set out in four orderly columns. The instructions made it unmistakably clear that only those marketers who were approved by the committee would be permitted to obtain products from the Tripoli refinery.

SUMMARY

The history and development of the Iraq Petroleum Co., Ltd., is a striking illustration of the evolution of joint control through common ownership. By operating through the common ownership mechanism, the major international companies were able effectively to restrain competition.

IPC was not operated as an independent profit-making company. It was essentially a partnership for producing and sharing crude oil among its owners. Its profits were kept at a nominal level as a result of the practice of charging the member groups an arbitrarily low price for crude—a practice which reduced IPC's tax liability to the British Government and permitted the refining and marketing subsidiaries of the groups to capture the major share of the profits resulting from IPC's operations.

Although the origin of IPC dates back to the early 1900's, it did not become important in world oil circles until after World War I. Restrictive arrangements came early in the life of the company, e. g., the Foreign Office agreement of 1914. For the most part, however, the significant restrictions were not developed until the midtwenties.

In the early twenties, when the American oil companies first became interested in oil concessions in the Middle East, they placed great emphasis on what was termed the "open door" policy, and, in fact,

[4] Minutes of group meeting March 14, 1946.

[5] Notes on group meeting March 14, 1946.

[6] The letter of instruction named the members of the Cairo committee and reminded them that IPC was entitled to all the products manufactured in the Tripoli refinery. More important instructions were as follows:

"It is suggested that you and the other gentlemen above referred to should constitute yourselves an informal committee and should write a letter prior to the first day of each quarter to the refinery manager of the Iraq Petroleum Co., Ltd., at Triploi *instructing him as to the quantities of each product which he should deliver and invoice to each separate Syrian or Lebanese local marketer for the ensuing quarter.* The form of the letter which it is suggested you should address to the Tripoli refinery is attached.

"*In allocating supplies from the refinery to marketers in Syria and Lebanon you will, of course, have regard to the supplies from this source which they have hitherto respectively enjoyed, but you are not thereby precluded from admitting other marketers, to participate in the products of the refinery, if you think fit.* We accordingly authorize the committee to deal on behalf of this company with a request of the Syrian Government (received through the Lebanese Government) to admit other persons to the *privileges hitherto enjoyed only by the members of the G. P. S. L.* which will be forwarded to you by IPC.

"Should the Tripoli refinery manufacture any product or products in excess of the requirements of the local market, these will be disposed of by arrangements made between the Iraq Petroleum Co., Ltd., and the shareholders, who will issue their instructions with regard to such disposal direct to the manager of the Tripoli refinery."

Quoted from a letter from D'Arcy Exploration Co., Ltd., to D. R. Mackintosh, Shell Co. of Egypt, Ltd., June 19, 1946. [Italics added.]

made the acceptance of this policy a sine quo non of their participation in IPC. In this, they were actively supported by the American Government. In its initial stages the "open door" policy was broadly interpreted to mean freedom for any company to obtain, without discrimination, oil concessions in mandated areas, particularly in Mesopotamia. It was designed to promote active competition among the various companies for oil concessions and to prevent the establishment of a monopoly of oil rights. However, the "open door" was gradually closed by a series of deliberate and systematic acts on the part of the owners of IPC. The first of these acts was the concession agreement between TPC (later IPC)[7] and the Iraq Government of March 14, 1925, which made it practically impossible for a nonmember of IPC to obtain a lease or concession in the areas that were to be opened for competitive bidding. Competition for these areas was changed from public or auction bidding to sealed bidding, with IPC given the authority to open the sealed bids and make the awards. In the original "open door" plan, IPC had been prohibited from bidding on plots to be offered at public auction. This prohibition, however, was omitted from the 1925 concession agreement. Thus, IPC was enabled to outbid any outsider, since (*a*) under the concession agreement all proceeds from bidding were to go to IPC, and (*b*) IPC had the right, upon meeting any submitted bid, to award the concession to itself. Secondly, when the groups signed the red-line agreement in 1928 and agreed not to be interested in the production or purchase of oil in the defined area other than through the IPC, they further closed the "open door" insofar as their own activities were concerned. Finally, the concession agreement of 1931 closed the door not only on the groups themselves, but on all others as well by eliminating all references to a selection of plots to be offered outsiders, thus giving IPC a monopoly over a large area of Iraq. The "open-door" policy which had been so strongly advanced was discarded in subsequent years without a single test of its adequacy as a practical operating principle.

During the period between 1922, when the "open door" policy was first advanced, and 1927, when it was in the process of being discarded, radical changes took place in the world oil situation. The fears of an oil shortage which were so widespread in 1922 were drowned in a surplus of oil. Instead of competing for the development of oil resources, the international companies turned their attention to limiting output and allocating world oil markets.[8]

With the admission in 1928 of the American group to a share interest in IPC, four of the large international oil companies (Anglo-Iranian, Royal Dutch-Shell, Standard Oil Co. (New Jersey), and Socony-Vacuum) were united for the first time in a joint venture. The American group, acting as a unit through the Near East Development Corp. (NEDC), along with Anglo-Iranian and Royal Dutch-Shell, comprised the three major groups necessary to control and shape the operating policies of IPC.[9]

An important restrictive feature of the IPC was the red-line agreement of 1928, which prevented the member groups of IPC from competing with themselves and with IPC for concessions in an area which

[7] Turkish Petroleum Co., Ltd., changed its name to Iraq Petroleum Co., Ltd. (IPC), in 1929.
[8] See chs. VIII and IX.
[9] Resolutions could be passed at a board meeting only if three major groups voted favorably. The other major group was CFP.

included most of the old Ottoman Empire. One writer in commenting upon the red-line agreement stated:

> This agreement is an outstanding example of a restrictive combination for the control of a large portion of the world's oil supply by a group of companies which together dominate the world market for this commodity.[10]

Although the strongest proponents of the red-line agreement were the French and Gulbenkian, the Big Three were not unalterably opposed to its adoption. The American group, although opposed to the red line when first advanced, later agreed to its adoption.

The red line gave adequate protection against independent action by the groups within IPC, as was evidenced by IPC's refusal to permit Gulf Oil Corp. from exercising its option to purchase a concession in Bahrein. However, there was a loophole in the agreement in that it did not prevent nonmembers from seeking concessions within the red-l,ne area. When an independent organization, the British Oil Development Co. (BOD), obtained a concession in the Mosul area of Iraq, and when another outsider, Standard of California, obtained concessions in Bahrein and Saudi Arabia, IPC began to secure as many concessions as possible within the red-line area, principally for the purpose of keeping them out of the hands of competitors. To offset the BOD and Standard of California's encroachments in the red-line area, IPC subsequently obtained control of the BOD concession by secretly purchasing its shares, while the Big Three attempted to come to an understanding with Standard of California regarding the Bahrein and Saudi Arabian concessions.

But the red-line agreement proved to be a serious handicap to the Big Three in their efforts to make a deal with Standard of California. It was a handicap to the Big Three because the French and Gulbenkian were unwilling to waive their rights under the red-line agreement which entitled them to their pro rata share of any concessions, of any crude produced, or of any products derived from crude produced within the red-line area. The Big Three tried, either individually or collectively, for almost 7 years, to alter the red-line agreement in such a way that they would be able to neutralize the competitive effects of Standard of California's operations, with, however, only partial success. When World War II interrupted negotiations, the IPC groups had reached a temporary understanding among themselves in the form of an agency agreement for purchasing Bahrein's production. This arrangement, however, fell far short of their real objective, which was a partnership agreement with Standard of California and Texas Co.[11] covering the Arabian concession.

During the war, the red-line agreement was more or less put aside. Some of the groups, like CFP and Gulbenkian, were considered enemies and could not share in IPC's production nor actively participate in the management of the company. Others, like Standard Oil Co. (New Jersey), could not lift their share of crude because of shipping restrictions. Despite the disruptions of the war, IPC followed its established price policy which assured a low price to the groups able to take IPC crude, although such a policy was of course unfavorable to the interests of the inactive parties.

At the end of the war, CFP and Gulbenkian were reinstated and the question of reaffirming the red-line agreement became a pressing issue.

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[10] Mikesell and Chenery, Arabian Oil, p. 45.
[11] The Texas Co. had obtained an interest in the Arabian concession in 1936.

The American group, instead of reaffirming the agreement, declared it dissolved because (*a*) some of the owners had been enemies during the war, and (*b*) its restrictive provisions violated the American anti-trust laws. It must also be remembered that at this time, Jersey Standard and Socony-Vacuum (the American group in IPC) were extremely anxious to purchase an interest in the Arabian American Oil Co. (Aramco), the company which held the Standard of California and Texas Co.'s concession in Saudi Arabia. It was the red-line agreement which before the war had blocked their efforts to secure a participation in these same concessions, the value of which had increased immensely during the war. It not only had been proved, but had developed into one of the world's most important oil concessions. As long as the red-line agreement hung around their necks like a millstone, the Big Three were placed in the role of unwilling outsiders, watching Standard of California develop this great new area, with possible disastrous effects on world price and markets.

Following declaration by the American group that the red-line agreement was dissolved, the French (CFP) filed a suit in the British courts to enforce the agreement and to obtain their proportionate share of any interest which the American group might secure in Aramco. But in November 1948, before the court case came to trial, a new agreement was negotiated freeing the IPC groups from many of the restrictive provisions of the red-line agreement and permitting the American group to purchase an interest in Aramco. The new agreement made it somewhat easier for a member of IPC to obtain oil in excess of its pro rata share. This was of considerable benefit to CFP, which for years had desired more oil from IPC, but under the red-line agreement was permitted to take only its pro rata share of IPC's production, as determined by the majority of the groups.

Under the new agreement, the groups were free to engage not only in individual but also in common ownership arrangements in other sections of the red-line area. The groups continued to obtain crude at an arbitrarily low price, and the Big Three retained their position of control over IPC's policies and management.

After World War II, when the exigencies of the moment made it necessary for IPC to operate a refinery at Tripoli, the major groups in IPC concertedly acted together to control the prices and the distribution of the refinery's products in such a manner as to discriminate against outsiders and further the interests of the major groups' marketing organizations.

In summary, the fundamental purposes and objectives of IPC were described by the French in a confidential document:

> The incorporation of IPC and the execution of the red-line agreement marked the beginning of a long term plan for the world control and distribution of oil in the Near East.[12]

IPC was so operated as:

> * * * to avoid any publicity which might jeopardize the long term plan or the private interests of the groups * * *.[13]

[12] From Observations, a memorandum prepared by CFP, for consideration by the major groups in relation to events arising since the war, February 27, 1947.
[13] Ibid.

CHAPTER V

OTHER COMMON OWNERSHIPS IN THE MIDDLE EAST

In addition to IPC, other joint ventures of major importance in the Middle East are the Arabian American Oil Co. and the Kuwait Oil Co., Ltd. The combined average daily crude production of these companies, in 1950, was approximately 900,000 barrels, which was more than one-half of total production in the Middle East and about 8.6 percent of world production.[1] Undoubtedly, these companies, because of their vast flush fields, will be important suppliers of petroleum for many years to come.

THE ARABIAN AMERICAN OIL CO.

The Arabian American Oil Co. has extensive oil operations in Saudi Arabia, and, except for the Bahrein Petroleum Co.'s operations on Bahrein Island, is the only company holding an important oil concession in the Middle East that is exclusively American-owned and operated.

In recent years the Arabian American Oil Co. (hereafter called Aramco) has increased its operations to such a point that, in 1950, it accounted for 5.3 percent of world production and about 35 percent of all production in the Middle East.[2] Although Aramco did not discover oil in Saudi Arabia until 1938, production increased from an average of 11,000 barrels per day in 1939 to 547,000 in 1950,[3] which made it the second largest producer of oil in the Middle East, exceeded only by the operations of Anglo-Iranian in Iran.[4] The rapid development by Aramco of the oil resources of Saudi Arabia can be traced directly to the ingenuity and persistence on the part of the participating American companies in the face of numerous obstacles. The rapid growth of Aramco's production is shown below:[5]

Year:	*Barrels daily*	Year—Continued.	*Barrels daily*
1939	11, 000	1947	246, 000
1940	15, 000	1948	390, 000
1941	12, 000	1949	477, 000
1942	12, 000	1950	547, 000
1943	13, 000	1951:	
1944	21, 000	First 6 months	671, 251
1945	59, 000	May	739, 780
1946	165, 000	June	758, 705

The original Aramco concession.—After Standard Oil Co. of California discovered oil on Bahrein in 1932, interest immediately shifted to Saudi Arabia, where it was believed the same geological formations

[1] World Petroleum, January 1951, p. 41.
[2] Ibid.
[3] Summary Middle East Oil Development, by Arabian American Oil Co. and World Petroleum, January 1951.
[4] World Petroleum, op. cit.
[5] Sources: Summary Middle East Oil Developments, by Arabian American Oil Co. for years 1939–46; for 1947–50, Bureau of Mines; and for 1951, Platt's Oilgram News Service, July 12, 1951.

existed.[6] Such an attractive oil prospect interested IPC as well as Standard of California, and competition for the concession was keen, with Standard of California winning out in the bidding.[7]

The concession granted to Standard Oil Co. of California on May 29, 1933, and assigned to California Arabian Standard Oil Co.,[8] a wholly owned subsidiary, on December 29, 1933, covered approximately 360,000 square miles, an area comparable in size to the States of Washington and Oregon.[9] In addition, the company was given a preference right to acquire additional oil concessions in Saudi Arabia by meeting the terms of any other offers made to the Government.[10] The concession agreement was to run for 66 years.

As consideration for the concession, the company was to make an initial loan of 30,000 pounds, in gold or its equivalent, plus an annual payment of 5,000 pounds, payable in advance; and, if the agreement was not terminated in 18 months, the company was to make a second loan of 20,000 pounds.[11] The loans were not repayable and were to be recovered by deductions from royalties.[12] Upon discovery of oil in commercial quantities, the company was to advance the Government 50,000 pounds and a similar amount was to be paid 1 year later—both payments to be recoverable by deductions from royalties.[12] On all oil produced, the company was to pay a royalty per ton of 4 shillings gold or its equivalent. If paid in dollars, adjustments for changes in the exchange rate between dollars and 4 shillings gold were to be made in accordance with a formula set forth in the agreement.[13]

The company was required to erect a refinery to supply the Government with sufficient gasoline and kerosene to meet ordinary requirements, and it was understood that ordinary requirements was not to include resale of products inside or outside the country.[14] To meet these "ordinary requirements" the company, upon completion of the refinery, was to supply free to the Government 200,000 gallons of gasoline and 100,000 gallons of kerosene annually.

The Texas Co. obtains a 50-percent interest in the Arabian concession.—In 1936, the Standard Oil Co. of California and the Texas Co. made an agreement whereby the Texas Co. received a 50-percent interest in the Saudi Arabia and Bahrein concessions (held by Standard of California) and, in return, Standard of California received a 50-percent interest in the Texas Co.'s far eastern marketing facilities.

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[6] The Bahrein concession and the conditions under which it was obtained have been previously noted. See p. 71 ff.

[7] See Collier's, August 18, 1945, All the King's Oil, an article by Marquis Childs, for an interesting and colorful account of how Standard of California obtained the concession.

The New York Times, July 15, 1933, p. 1, reported that fear of British political control was a factor in influencing King Ibn Saud to award the concession to an American company.

The following comment was made in 1935 by the general manager of IPC to NEDC'S representative on the IPC board; "* * * there was a time when you were all sure that there could be *no oil at all* in Bahrein. And, as for Hasa (Hasa was that section of Arabia where the concession area was located), I told the groups that that concession would be theirs within 48 hours if they planked down £50,000 (gold); they replied that I was far too hasty—'Try Ibn Saud with £30,000 sterling'; within 48 hours California deposited £50,000 (gold) and walked away with it." Apparently IPC was too conservative in its bidding. From a letter by J. Skliros to R. W. Sellers, October 31, 1935.

[8] The name of California Arabian Standard Oil Co. was changed to Arabian American Oil Co. (Aramco) on January 31, 1944.

[9] Arabian Oil, op. cit., p. 52. One source gives the size of the area as approximately 162,000,000 acres. See Investigation of the National Defense Program, hearings before a Special Committee Investigating the National Defense Program, U. S. Senate, 80th Cong., 1st sess., pursuant to S. Res. 46, pt. 41, p. 24724.

[10] Private letter agreement between Saudi Arabian Government and Arabian-American Oil Co., May 29, 1933.

[11] All payments were to be in gold or its equivalent.

[12] Original concession agreement between Saudi-Arabian Government and Standard Oil Co. of California, May 29, 1933.

[13] Ibid. In 1950, the royalty amounted to about 34 cents per barrel.

[14] Ibid.

To understand the significance and reasons for this merger, it is necessary to review briefly some of the events that preceded it. Prior to the discovery of oil in Bahrein by the Standard of California in 1932, the world oil situation was being molded to conform to a definite pattern of cooperation, which included limitations on production, sharing of markets, and stabilization of prices.[15] Thus, the Bahrein discovery was a disturbing event. Standard of California was a newcomer, and as one source put it—

> * * * what each large oil group fears more than anything else is the entry of a powerful newcomer in the established order of world oil markets.[16]

The Bahrein operation was immediately recognized as a threat to the world stabilization plans [17] of Anglo-Iranian, Shell, and Jersey Standard, and these companies lost no time in trying to work out a marketing agreement with Standard of California which would neutralize the effect of Bahrein crude.[18] However, these negotiations failed,[19] and Standard of California proceeded, in 1935–36, to construct a refinery at Bahrein, which, however, presented it with the problem of finding a market for refined products. For some years Standard of California had depended on Socony-Vacuum to market its products in the Far East,[20] and it had not itself developed any foreign marketing facilities or marketing position outside of the United States. Standard of California, therefore, was not recognized as being entitled to an established marketing position under the cartel arrangements which controlled world markets.[21]

The Big Three international oil companies were fearful that Standard of California would force Bahrein products into world markets by reducing prices, a course of action which, however, would be detrimental to Standard of California's own interests in the United States.[22] Such was the position of Standard of California in 1936, prior to its merger with the Texas Co.

Standard of California evidently concluded that the way out of the dilemma was to purchase existing marketing organizations and thus obtain a marketing position which would make it possible to market Bahrien products without having to grant price concessions. Early in 1936, Standard of California opened negotiations with the Texas Co. for an interest in its far eastern marketing facilities. The Texas Co. had developed markets in Europe, China, Australasia, Africa, and other areas in the Far East and had supplied these markets with products from the United States. Thus it was to the mutual advantage of Texas and Standard of California to merge these interests—Texas to obtain a source of supply nearer than America, and Standard of California to obtain an outlet for Bahrein products. In reference

15 These are discussed in detail in chs. VIII and IX of this report.
16 The Petroleum Times, London, May 2, 1936, p. 563.
17 These plans are discussed in chs. VIII and IX.
18 The efforts of these companies to cope with the Bahrein problem have been discussed in ch. IV. See p. 72 ff.
19 A report in the Petroleum Times, May 2, 1936, p. 563, indicated that the failure might have been due to the refusal of the European cartels to agree to their (referring to K. R. Kingsbury and James Moffett of Standard of California) desires concerning a controlled market for Bahrein crude.
20 Fortune, The Great Oil Deals, May 1947, p. 175.
21 These "as is" arrangements, as they were known, provided for the allocation of world markets among existing marketing organizations in accordance with the marketing positions held in 1928 in each market. See chs. VIII and IX for a discussion of these arrangements.
22 The Petroleum Times, February 20, 1937, p. 263. The discussion is in reference to Caltex, a few months after the California-Texas merger, but the reasoning is just as applicable to conditions before the merger. One commentator also indicated that K. R. Kingsbury, president of Standard of California, and Walter Teagle, president of Jersey Standard, had personal differences and were never reconciled. This may have made things more difficult for Standard of California. See Fortune, "The Great Oil Deals," op. cit.

to a report that negotiations between Texas and Standard of California were proceeding, one commentator stated:

> Some such move would not be unlikely, following the failure to come to terms on a marketing agreement for Bahrein crude with the other international powers. * * * [23]

On July 1, 1936, an agreement was made between Standard of California and the Texas Co., whereby Standard of California received a one-half interest in the Texas Co.'s marketing facilities east of Suez and the Texas Co. a one-half interest in the Bahrein concession and facilities.[24] Later, in December 1936, an additional arrangement was completed by Standard of Calfornia and the Texas Co. under which the Texas Co. received a one-half interest in California Arabian Standard Oil Co. (now Aramco), holder of the Saudi-Arabian concession. As consideration, the Texas Co. agreed to pay $3 million in cash and $18 million in deferred payments to be paid out of Arabian production.[25]

Standard of California now had a marketing outlet for Bahrein products and for any production that might be developed by Aramco in Saudi Arabia. In commenting upon the California-Texas arrangement the Petroleum Times stated that—

> it is a natural outcome of the failure of the Standard of California to reach an agreement with the Royal Dutch-Shell, Jersey Standard, and Anglo-Iranian groups late last year when a series of conferences were held.[26]

The same source went on to point out that from the standpoint—

> * * * of world oil circles the advantage of this merger is that, both companies being sound, stable and conservatively managed, it assures that Bahrein production, as well as any output that may eventually come from countries now being developed by Standard of California, *will have assured and regulated outlets and will so lessen any possible danger of upsetting the equilibrium of international markets.*[27]

However, it should be noted that Standard of California's outlets were only east of Suez—a factor which turned out to be of considerable importance.

Oil discovered in Saudi Arabia and a supplemental agreement concluded.—Under the original concession agreement with Saudi Arabia, exploration work was to commence by September 1933. Test drilling was begun in 1934. At first the results were discouraging, but, on October 16, 1938, oil was discovered in commercial quantities in the Dammam field.[28] There then ensued a rush by various parties, particularly representatives of the Axis nations (Germany, Italy, and Japan) to obtain a concession in Saudi Arabia. IPC was also on the

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[23] The Petroleum Times, May 16, 1936, p. 626.

[24] Investigation of the National Defense Program, op. cit., pp. 24836, 24837; and Moody's Industrials, 1950, p. 2810.

The marketing subsidiaries in which Standard of California obtained a 50-percent interest were the Texas Co. (Australasia), Ltd., the Texas Co. (China), Ltd. the Texas Co. (India), Ltd., the Texas Co. (South Africa), Ltd., and the Texas Co. (Philippine Islands), Inc. The Texas Co.'s marketing properties in Egypt were included in the 1936 merger deal. See Investigation of the National Defense Program, op. cit. p. 24837.

The Bahrein concession was held by Bahrein Petroleum Co., Ltd., a Canadian corporation. As a result of the merger, a subsidiary of Bahrein Petroleum Co., Ltd., was formed, called California Texas Oil Co., Ltd. (Caltex), and to this company was transferred control of the marketing facilities.

[25] Moody's Industrials, 1950, p. 2810. In addition, for the consideration, Texas received a 50-percent interest in N. V. Nederlandsche Petroleum Maatschappij, which held a concession in Sumatra, and a 20-percent interest in N. V. Nederlandsche Nieuw Guinee Petroleum Maatschappij, which hold a concession in Dutch New Guinea. In the same transaction the Texas Co. gave Standard of California an option to purchase one-half of its marketing facilities in Europe. The option lapsed in 1939; but, in December 1946, Caltex paid Texas Co. $28 million for these facilities. See Fortune, op. cit.

[26] The Petroleum Times, July 4, 1936, p. 8.

[27] Ibid. [Italics added.]

[28] Summary Middle East Oil Developments, op. cit., and supplemental agreement between Saudi Arabian Government and California Arabian Standard Oil Co., May 31, 1939.

scene with offers.[29] But the California Arabian Standard Oil Co. was the successful bidder, and on May 31, 1939, a supplemental agreement was concluded between the company and the Saudi Arabian Government, which added approximately 80,000 square miles to the original concession area. This increased the total concession area held for the exclusive use of the company to about 440,000 square miles, equal to about one-sixth the area of the United States.[30]

For extending the territory and making other modifications in the original concession agreement, the company agreed to pay the Saudi Arabian Government 140,000 English pounds in gold, or its equivalent, at the time the supplementary agreement became effective. In addition, the company was to pay an annual rental of 20,000 English pounds in gold, or its equivalent, until oil was discovered in the "additional area" in commercial quantities or until the company relinquished the area.[31] However, if oil were discovered in the additional areas, the company was to pay 100,000 English pounds in gold, or its equivalent, and increase the quantity of free gasoline and kerosene supplied to the government.[32] No change was made in the per ton royalty payments, but the terms of the concession were extended for 60 years, dating from 1939.

Developments during World War II.—Following the discovery of oil in Saudi Arabia, in 1938, further drilling and exploration work continued, and by the end of 1941 three important oil fields had been discovered.[33] For a time crude oil was barged to the refinery on Bahrein, which was located about 25 miles off the mainland of Saudi Arabia. But additional facilities were necessary, and, by 1939, a deep-water loading terminal and storage facilities had been constructed at Ras Tanura (on the Persian Gulf), and a pipeline was completed from the producing fields to the loading terminal.[34] In 1940, a small refinery of 3,000 barrels daily capacity was constructed at Ras Tanura to supply the local requirements of the government and the company. Except for a large refinery constructed at Ras Tanura in 1943–45 as a military project, and an underwater pipeline from the Arabian fields to the Bahrein refinery, there were few new developments made by Aramco until the end of the war.[35]

Nevertheless, by 1941, sufficient exploration and development work had been completed to prove beyond question the existence of vast oil reserves in the Aramco concession. Although Aramco's production in 1940–41 was small, ranging from 12,000 to 15,000 barrels per day, one individual long associated with Aramco indicated that, in 1941, Aramco could have produced from 100,000 to 200,000 barrels per day.[36] Thus the owners of Aramco, i. e., Standard of California and the Texas Co., were faced with the problem of finding an outlet for an extremely large quantity of oil.

[29] Arabian Oil, by Mikesell & Chenery, p. 53.
[30] Summary Middle East Oil Developments, op. cit., Arabian Oil, op. cit. p. 53, and supplemental agreement, op. cit.
[31] A part of the new territory over which Standard of California obtained concession rights under the supplemental agreement, included Saudi Arabia's undivided half-interest in the Saudi Arab-Kuwait and Saudi Arab-Iraq neutral zones. Supplemental agreement, art. 4.
[32] Supplemental agreement, art. 8.
[33] Summary Middle East Oil Developments, op. cit.
[34] Arabian Oil, op. cit., p. 61.
[35] Summary Middle East Oil Developments, op. cit. Actually the name of the company holding the concession at this time was California Arabian Standard Oil Co. (called Calarabian) and its name was not changed to Arabian American Oil Co. (Aramco) until 1944, but for the sake of clarity, Aramco is used.
[36] See testimony of James A. Moffett in Investigation of National Defense Program, op. cit., p. 24714.

In 1941, the owners of Aramco offered to sell petroleum products to the United States Government at reduced prices if certain specified conditions were met.[37] Briefly, the more important conditions were that if the United States Government would advance $6,000,000 annually for 5 years to the King of Saudi Arabia, then Aramco would contract with the King to produce the products ($6,000,000 worth annually) and deliver them to the United States Government, f. o. b. ship at Persian Gulf, for the account of the King. In essence, it was a three-cornered arrangement; the advance payments would give financial relief to the King of Saudi Arabia, the United States Government would obtain petroleum products at special prices, and Aramco would have a market for its products as well as relief from the burden of making further advances to the King against future royalties.[38] The quantities of products and the offering prices were as follows: [39] 1,800,000 barrels gasoline at 3½ cents per gallon, 2,660,000 barrels Diesel fuel at 75 cents per barrel, 3,400,000 barrels fuel oil at 40 cents per barrel. Another condition of the offer stated that—

> The products taken under this arrangement, except that taken for use by the United States Navy or other United States Government purposes within the area, *would have to be moved outside an area approximately defined as follows:* Egypt, the East Coast of Africa, South Africa, Australasia, India, the Straits Settlements, China, Japan and possibly the Philippines.[40]

It is clear that under the above provision, no private sales were to be made by the United States Government for use in the excluded areas. These excluded areas were precisely the same areas "east of Suez" served by the joint subsidiaries of Texas and Standard of California which marketed Bahrein and Aramco oil.[41] An explanation for limiting sales in the excluded areas was given by James Moffett, former chairman of the board of Bahrein Petroleum Co., Ltd., and its wholly-owned subsidiary, Caltex,[42] before a special Senate committee in 1947–48. It was his view that Bahrein and Caltex had their full share in those markets and if the government made sales in the area "it backed up that much elsewhere and did not give the relief." [43] Relief, i. e., more sales of Bahrein and Aramco products, could be obtained only by finding markets *outside* the restricted or excluded area. Mr. Moffett stated that Bahrein and Caltex had "cartel" arrangements in the British Empire territory and that "* * * they had a certain percentage in that market * * *" [44] Specifically, referring to the excluded territories or the Caltex markets east of Suez, he said "* * * we were operating under cartels and also what was known as the 'As-is position' * * *" [45]

Clearly, Texas and Standard of California were thus limited as to markets, and their offer to the United States Government was an

[37] Investigation of the National Defense Program, op. cit., pp. 25359-25361. This hearing also sheds light on the prices Aramco charged the United States Navy for crude and products in 1945. See chapter X of this report for a discussion of this subject.

[38] See Investigation of the National Defense Program, op. cit., for a complete discussion of this proposal, the reasons for the advance and the King's financial plight.

[39] Ibid., p. 25359.

[40] Ibid., pp. 25360–25361. [Italics added.]

[41] It will be recalled that Standard of California acquired a 50-percent interest in the Texas Co.'s marketing subsidiaries operating east of Suez in the 1936 transaction described on pp. 115–116; see especially footnote 24, p. 116. Actually ownership of these facilities was directly held by California Texas Oil Co., Ltd. (Caltex) a jointly owned subsidiary of the two companies.

[42] Both these companies were jointly owned by Standard of California and the Texas Co.

[43] Testimony of James Moffett in Investigation of the National Defense Program, op, cit., p. 24727. The committee that made this investigation was popularly known as the Brewster committee.

[44] Ibid. p. 24728.

[45] Investigation of the National Defense Program, op. cit., p. 25201. See chs. VIII and IX for a discussion of the "As Is Position."

attempt to find an additional outlet for Aramco and Bahrein oil and at the same time not violate existing cartel arrangements. But the United States offer was never acted upon [46] and, until the end of the war, Aramco's principal sales outlets were its limited markets east of Suez and the military departments of the Allied Governments. The latter purchased considerable quantities of crude oil and petroleum products from Aramco during the war,[47] but these sales were only in temporary markets. What Aramco needed was a permanent market for its vast oil potential which would justify the large investments necessary for adequate development of this latent resource.

Aramco's position at the end of the war.—Because of their strategic location, the Aramco and Bahrein operations benefited from the war. A big refinery was constructed at Ras Tanura which turned out large quantities of Diesel and fuel oil for the Navy. The capacity of the refinery on Bahrein Island was expanded; some additional wells were drilled and a few short pipelines were built. The additional refinery capacity enabled Aramco to increase its production from 21,296 barrels daily, in 1944, to 58,386 barrels, in 1945, most of which was for military use. A new oil field was discovered in 1945, making a total of four fields in the Aramco concession.[48] Also, because Aramco was an important supplier of oil products to the military, it was able to assemble and maintain a technical organization. This combination of circumstances placed Aramco in a position to expand rapidly when the war ended.

During the war a plan was conceived to build a pipeline from the Arabian oil fields to the Mediterranean. The United States Government had proposed to build the line in 1944, as a possible means of relieving the tanker shortage, but the proposal was rejected.[49] When the war ended Aramco revived the project as a private venture without government participation.

With its oil fields proven to the extent of several billion barrels, with added refinery capacity, with basic development work completed, and with plans well under way for the construction of a large diameter crude oil pipeline from Arabia to the Mediterranean,[50] Aramco, at the end of the war, was capable of supplying oil in quantities far beyond its prewar production. The question of where it would market this oil was a matter of concern not only to Standard of California and the Texas Co. (Aramco and Bahrein's parents) but also to the other international companies.

Jersey Standard and Socony-Vacuum purchase an interest in Aramco and Trans-Arabian Pipe Line.—Aramco did not long remain the exclusive property of Standard of California and Texas. Shortly after the war ended Jersey Standard and Socony-Vacuum acquired an

[46] In 1943, the parents of Aramco again offered oil products to the U. S. Government at special prices. They also offered to set aside part of Aramco's reserves of oil for use by the Government. In return, the U. S. Government was to give financial aid to the Saudi Arabian Government. See Investigation of the National Defense Program, op. cit., and S. Rept. No. 440, pt. 4, 80th Cong., by the same special committee for a discussion of these issues.

[47] Investigation of the National Defense Program, op. cit. The same source sheds light on the attempts of the U. S. Government, through Petroleum Reserves Corp. (a subsidiary of the Reconstruction Finance Corp.) to purchase the stock of Aramco and the Bahrein Petroleum Co. Later the proposal was amended to provide for the purchase of only a minority interest, but the parent companies (Standard of California and Texas Co.) refused to sell and the deal was dropped. Also see Arabian Oil, op. cit., pp. 90–95.

[48] Summary Middle East Oil Developments, op. cit., and Arabian Oil, op. cit., pp. 61–62.

[49] Investigation of the National Defense Program, op. cit., pp. 25235–25246.

[50] This pipeline was completed in 1950 by Trans-Arabian Pipe Line Co., which was incorporated in July 1945, and is owned by the same interests that own Aramco. See following sections of this report for further discussion of this subject.

interest in Aramco and its pipeline to the Mediterranean, Trans-Arabian Pipe Line Co. (hereafter called Tapline). Discussions with Standard of California and the Texas Co. were initiated by Jersey and Socony sometime before mid-1946. By December of that year, an agreement in principle had been reached whereby Jersey Standard and Socony-Vacuum would obtain a 30-percent and a 10-percent interest, respectively, in Aramco and Trans-Arabian Pipe Line Co.[51] By March 12, 1947, all details were worked out, and the formal documents were signed on that date. The documents—Jersey Standard and Socony each made seven agreements on that date—included:

(*a*) Loan guaranty agreements (called loan agreements), whereby Jersey and Socony guaranteed payment of a $102,000,000 loan which Aramco was obtaining from a group of banks.

(*b*) Aramco-Jersey and Aramco-Socony stock subscription agreements.

(*c*) Trans-Arabian-Jersey and Trans-Arabian-Socony stock subscription agreements.

(*d*) Pipeline agreement between Jersey, Socony, Standard of California, the Texas Co. and Trans-Arabian Pipe Line.

(*e*) Interim off-take agreement between Jersey, Socony, Caltex Oceanic, Ltd. (owned by Standard of California and Texas Co.) and Aramco.

(*f*) Off-take agreement between same parties as in (*e*) above.

(*g*) Letter agreement between Jersey, Socony, and Aramco regarding the settlement of a gold royalty problem with the Saudi Arabian Government.

Jersey Standard and Socony each signed further agreements on December 31, 1947, known as the refined products off-take agreements.

The significant features of these eight agreements are discussed below. At this point it should be noted that a condition precedent to their becoming effective was a favorable settlement of the red-line controversy.[52] If the red-line problem were not concluded favorably to Jersey and Socony within 4 years (by March 12, 1951), or if a court decision adverse to the interest of Jersey and Socony were rendered prior to March 12, 1951, the agreements giving Jersey and Socony an interest in Aramco and Trans-Arabian Pipe Line were to terminate. Most of the agreements of March 12, 1947, were not to become effective until Jersey Standard and Socony became shareholders in Aramco and Trans-Arabian Pipe Line. A few, however, such as the loan guaranty agreements, the interim off-take agreement of March 12, 1947, and the refined products off-take agreement of December 31, 1947, were put into effect immediately.

The Jersey-Socony-Aramco arrangement opens up markets for Aramco's oil.—Before discussing the details of the Jersey-Socony-Aramco agreements, it is necessary to examine the rationale underlying the admission of Jersey and Socony into Aramco.

As noted above, Aramco emerged from the war as one of the important foreign oil holdings of the world with not only a tremendous potential to produce crude but a necessity of producing in substantial quantities to increase the total royalty payment to the King of Saudi

[51] Executive committee minutes.
[52] See p. 101 ff. for a discussion of the "red-line" controversy.

Arabia.[53] In short, Aramco's production could not be readily shut in or retarded. The owners of Aramco (Standard of California and the Texas Co.) were apparently faced with the choice of either forcing their way by competitive means into markets which, before the war, had been closed to them because of international cartel arrangements, i. e. the "as is position," [54] or permitting companies which did have marketing outlets and positions in areas west of Suez to acquire a proprietary interest in Aramco.

If the former choice were made and the international companies refused to make way for Aramco's output, the stability of all oil concessions in the Middle East might be upset, particularly since King Ibn-Saud was unlikely to accept a program of limited output. Moreover, in view of the various pressures to produce, Aramco might attempt to force its way into international markets by competing pricewise.

But if the latter choice were made, Aramco's output would not unstabilize existing world prices and markets, as the production could be fitted into markets over a wide area without the need of price competition. Also, if necessary, adjustments could be made in the production rates of other areas operated by the purchasing companies in order to make room for Aramco's output.

The international oil companies decided to take the latter course of action. Texas and Standard of California would obtain additional markets for Aramco without having to compete for them, while Jersey and Socony, with their world-wide interests, could distribute their shares of Aramco's output, with the result that world prices and markets would not be disturbed. At the same time, Aramco could increase production and pay greater sums to the Saudi Arabian Government.

The latter course of action was, in effect, adopted in December 1946, when the four companies (Jersey Standard, Socony-Vacuum, Standard of California and Texas) agreed in principle to share ownership of Aramco. Almost immediately the Texas Co. sold its European marketing subsidiaries to California Texas Oil Co., Ltd.[55] The Texas Co. commented as follows upon the sale of these subsidiary marketing companies:

> For many years the company supplied its subsidiaries with products manufactured in the United States. It became apparent that with the increased domestic demand for petroleum and its products, and the development of petroleum resources in the Middle East, *these European markets can be more logically supplied through the Bahrein Petroleum Co., Ltd. (which through subsidiaries markets east of Suez) and Arabian American Oil Co.* with their respective facilities on the island of Bahrein and in Saudi Arabia. *Since these two companies will become the future source of supply for these European markets* and are jointly owned by the company and Standard Oil Co. of California, the company sold its

[53] On December 4, 1946, Harry T. Klein, president of Texas Co., and George V. Holton, vice president and general counsel of Socony-Vacuum, and Edward F. Johnson, general counsel of Standard Oil Co. (New Jersey), called on the Attorney General of the United States to discuss the proposed purchase of an interest in Aramco by Jersey and Socony. In a memorandum of the interview, prepared by Mr. Johnson, there appears the following:

"At the meeting, Colonel Klein explained that Aramco owned a large concession in Saudi Arabia; *that in order to keep King Ibn-Saud satisfied with the operation of the concession, it is important that production be increased substantially so that the King would receive greater royalties; that added production and the increase in royalties which would flow therefrom would tend to add stability to the concession;* that Standard Oil Co. of California and the Texas Co., owners of Aramco, *did not have outlets for the volume of crude that should be produced* * * *." From memorandum of interview with the Attorney General regarding Aramco. [Italics added.]

[54] See p. 118 and chs. VIII and IX for a discussion of "as is" arrangements.

[55] One source, Fortune, The Great Oil Deals op. cit., p. 143, gave the date as December 1946, while another, Moody's Industrials, 1950, p. 2811, said the sale took place as of January 1, 1947.

European subsidiaries to California Texas Oil Co., Ltd., also owned 50 percent by the company and 50 percent by Standard Oil Co. of California.[56]

Standard Oil Co. of California was somewhat more precise in its statement regarding the acquisition:

> A development which widens the outlet for Persian Gulf products was acquisition of the European marketing subsidiaries of the Texas Co. by Caltex, *which heretofore has operated throughout the area east of Suez. This move enables Caltex to expand immediately into the markets of northern and western Europe, and the countries bordering the Mediterranean Sea.* Caltex obtains the major portion of its supplies from the oil fields and refineries of the parent company interests in Saudi Arabia and Bahrein.[57]

From the above statements it is clear that prior to the acquisition of these European marketing subsidiaries, Caltex (the company that did the marketing for Aramco and Bahrein) could not market in Europe. Upon purchasing these subsidiaries, however, Caltex was enabled to move Aramco's output (as well as Bahrein's) into Europe and other markets adjoining the Mediterranean.[58]

Reasons advanced as a justification for Jersey and Socony obtaining an interest in Aramco were that Aramco needed additional capital to construct a pipeline and to carry on development work, which Standard of California and the Texas Co. were not in a position to supply, that Jersey and Socony needed oil and were willing to supply the capital needed by Aramco, and that Jersey and Socony had markets which they needed to supply from Middle East sources.[59]

Aramco's output could now be marketed not only in Europe, through the marketing outlets formerly owned by the Texas Co. (now owned by Caltex), but also through the extensive marketing outlets of Jersey and Socony, which were world-wide. Even before the agreements between Jersey-Socony and Aramco were consummated, Jersey and Socony began to purchase crude and refined products from Aramco.[60] The fact that Caltex (Standard of California and Texas Co.) was not permitted to market in areas west of Suez [61] until after the Jersey-Socony-Aramco agreement, is an indication that the "as is position" for sharing markets, which was in operation in 1941,[62] may have continued to be the international oil companies' modus operandi as recently as 1947.[63]

Agreements and terms of the participation of Jersey Standard and Socony-Vacuum in Aramco and Trans-Arabian Pipe Line.—In addition to agreements permitting Jersey Standard and Socony-Vacuum

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[56] The Texas Co. Annual Report for the year 1946, p. 12. [Italics added.]

[57] Standard Oil Co. of California Annual Report to Stockholders, 1946, p. 9. [Italics added.]

[58] In reference to the Texas Co.'s statement, it is difficult to understand why it was more logical for Texas to supply its European markets from its Middle East sources in 1947 than it was in years prior thereto. Texas had had an interest in Middle East sources for several years and it had the marketing facilities in Europe. The explanation for changing the supply source from America to the Middle East and the shift in ownership of the European marketing facilities may have been due to the opening up of European markets to Caltex. This may well have been part of the quid pro quo received in return for granting Jersey and Socony an interest in Armaco. A statement by Standard of California regarding the advantages to Aramco of the Jersey-Socony-Aramco agreement "in principle" of December 1946 is of interest.

"One of the advantageous results of participation in Arabian American by the two additional companies will be *the opening of their additional extensive marketing outlets to the oil products of Saudi Arabia*, thus permitting increased production from the vast stores of oil in that country. *Production has been limited by markets, not by the supply*" (Standard Oil Co. of California Annual Report to Stockholders, 1946, p. 8.) [Italics added.]

[59] From Memorandum of Interview with the Attorney General Regarding Aramco, March 18, 1947, by E. F. Johnson.

[60] See subsequent discussion of interim off-take agreement, p. 125.

[61] Standard Oil Co. of California Annual Report to Stockholders, 1947, p. 9. Since 1947, when Caltex (owned by Standard of California and Texas Co.) was first permitted to market west of Suez, this company has constructed refineries in Holland, Spain, and France. These refineries operate principally on Aramco crude. In a few years Caltex has become one of the important international suppliers of petroleum products.

[62] See pp. 118–119.

[63] See chs. VIII and IX on cartel arrangements.

to purchase a stock interest in Aramco and Trans-Arabian Pipe Line, there were several collateral agreements signed at the same time (March 12, 1947), including loan guaranty agreements, a pipeline agreement, a letter agreement concerning the settlement of a royalty controversy between Aramco and the Saudi Arabian Government, agreements relating to the repayment of loans and the amounts Aramco owed Standard of California and Texas Co., and agreements to purchase or off-take Aramco's production of crude and refined products.

The principal terms and conditions under which Jersey Standard and Socony-Vacuum were to share ownership of the Aramco-Trans-Arabian Pipe Line operations with Standard of California and Texas Co. are discussed below. Most of the agreements were signed on March 12, 1947, and became effective in December 1948, following the settlement of the red-line problem and the withdrawal of the CFP court suit in November of that year. Although Jersey and Socony did not become active owners of Aramco and Trans-Arabian until December 1948, nevertheless, under some of the agreements, they were able to take a share of Aramco's production and influence the marketing of Aramco's products prior to December 1948.

The Aramco-Jersey and Aramco-Socony agreements.—Under stock subscription agreements of March 12, 1947, Aramco granted Jersey Standard and Socony-Vacuum the right to subscribe to Aramco's capital stock in amounts sufficient to give Jersey a 30-percent and Socony a 10-percent interest in the company.[64] The remaining 60 percent was to be retained on an equal basis (30 percent each) by Standard of California and the Texas Co. For their respective interests in Aramco, Jersey was to pay $76,500,000 and Socony $25,500,000, a total of $102,000,000.[65] But, because of the red-line controversy and the court case filed by CFP, issuance of the stock and final consummation of the agreement had to await a settlement of the red-line question.[66] To meet this issue the Aramco-Jersey-Socony Subscription Agreements provided that in the event the court case regarding the red line was adjudicated or settled adversely to Jersey and Socony or if no settlement of any kind were made prior to March 12, 1951, the agreement would be terminated.[67] In the interim, however, Jersey and Socony were to guarantee $102,000,000 in bank loans to Aramco, with the understanding that if and when Jersey and Socony received their stock in Aramco, the funds paid therefor would be used by Aramco to repay the loans.[68] Upon receipt of the loan funds of $102 million, in March 1947, Aramco paid off debts to its parents (Standard of California and the Texas Co.) of approximately $79.8 million and declared a dividend of about $22.2 million, which was also received by the parent companies.[69]

In addition to the above consideration for their respective interests in Aramco, Jersey and Socony agreed to grant Standard of California and the Texas Co. a prior claim to Aramco's earnings. Jersey and

[64] Aramco-Jersey and Aramco-Socony Subscription Agreements, March 12, 1947. Jersey Standard was to have 3,500 shares and Socony 1,166⅔ shares.

[65] Aramco-Jersey and Aramco-Socony Subscription Agreements, op. cit.

[66] See p. 104 ff. for a discussion of this question.

[67] Aramco-Jersey and Aramco-Socony Subscription Agreements, op. cit.

[68] Agreement between Aramco and the "banks." Jersey's guaranty was $76,500,000 and Socony's $25,500,000. The loans were to be obtained from 19 large banks. See also Jersey Standard's Prospectus of June 11, 1948.

[69] From Report by Price Waterhouse & Co. to board of directors of Aramco, November 29, 1948.

Socony's shares in Aramco were excluded from participation in dividends until the aggregate amount of dividends paid on Standard of California and Texas Co.'s shares equaled $37,234,758 in 1947, $15,000,000 in 1948, $15,000,000 in 1949, and in each year beginning with 1950, a sum equivalent to 10 cents per barrel (U. S. 42 gallons) for each barrel of crude oil produced by Aramco until dividends based on a total production of 3 billion barrels ($300,000,000) had been paid.[70] All of these dividend payments were cumulative, i. e., if all of any part was not paid in the year when due, the obligation was carried over to the next year. Thus, the total financial cost to Jersey and Socony for their 40-percent interest in Aramco was nearly one-half billion dollars,[71] a major transaction even for international oil companies.

Jersey and Socony, in addition to receiving a 40-percent interest in Aramco, also obtained a limited veto with respect to the management of Aramco. The articles of incorporation were amended to permit changes in Aramco's bylaws only by a vote of not less than 66⅔ percent of the holders of capital stock.[72] Since Texas and Standard of California held 60 percent, this meant that either Jersey or Socony would have to agree before any proposed change could be made. Also, the board of directors of Aramco could not sell or transfer a substantial portion of the assets or property of the company unless the holders of 66⅔ percent of the stock so authorized.[73] Moreover, the articles of incorporation could be altered or changed only by a vote of 100 percent of the holders of the capital stock.[74] This same rule applied to the removal of directors from the board.[75] Thus, it would appear that Jersey and Socony obtained a voice in the management of Aramco considerably out of proportion to their stock holdings. Nevertheless, it was the stated intention of its owners that Aramco should be run for its own benefit as a separate entity,[76] as contrasted to IPC, which was operated for the benefit of the owning groups.

The Trans-Arabian Pipe Line agreements.—In agreements similar to the Aramco agreements, Jersey Standard and Socony-Vacuum obtained the right to subscribe to stock in Trans-Arabian Pipe Line Co. (hereafter called Tapline) in amounts necessary to give them a 30-percent and 10-percent interest, respectively, in Tapline.[77] The agreements contained the same contingent provisions regarding the settlement of the red-line controversy as the Aramco agreements. In other Tapline arrangements (articles of incorporation) Jersey and Socony obtained the same veto power in the management counsels of the company as they had received in Aramco; i. e., substantial changes

[70] Articles of Incorporation of Arabian American Oil Co., art. IV.

[71] Due to adjustments in Aramco's net worth and adjustments in payments made to settle a gold royalty controversy with the Saudi Arabian Government (as provided by letter agreement of March 12, 1947), the total payments made by Jersey and Socony, for their 30- and 10-percent stock interest, respectively, when the agreement was consummated in December 1948, were, Jersey $79,092,376.24 and Socony $26,234,-125.42, or a total of $105,456,501.66. (See letters from J. H. MacDonald of Aramco to Jersey and Socony November 24, 1948.) This $105 million plus was for stock interest only; when to this is added the dividend priority payments, the total cost to Jersey and Socony was about $450 million.

In addition to the large financial consideration, there is substantial evidence to support the inference that Standard of California and the Texas Co. also received very valuable marketing privileges. (See previous discussion regarding Aramco obtaining new marketing outlets.)

[72] Art. IX of articles of incorporation, as amended.

[73] Art. X, op. cit.

[74] Art. XV, op. cit.

[75] Art. IX, op. cit.

[76] Statement of intent.

[77] Trans-Arabian-Jersey and Trans-Arabian Socony subscription agreements, March 12, 1947. Jersey was to obtain 250 shares and Socony 83⅓ shares.

could be made only if 66⅔ percent, and in some cases 100 percent, of the stockholders approved.[78]

As consideration for their interests in Tapline, Jersey and Socony agreed to guarantee the payment of their proportionate share of a $125,000,000 loan to Tapline.[79] Jersey Standard's guaranty was $37,500,000 and Socony's $12,500,000, with Standard of California and Texas Co. guaranteeing the balance, i. e., $37,500,000 each.[80] This, in effect, was a four-party guaranty with each party liable for its proportionate share, not only of the $125 million, but of such additional amounts as would be needed from time to time to complete construction of the line.[81]

Each of the four parties was to have the right to ship crude through the line in proportion to their ownership, i. e. Jersey, Texas, and Standard of California, 30 percent each and Socony 10 percent. If one party did not choose to use its full share of the line, the unused share was available for any of the other parties who wished to utilize it. As consideration for the right to use the line, each party was to pay its pro rata share of the line's fixed charges,[82] except in cases where unused capacity of one shipper was used by another. In such cases the user paid additional fixed charges equal to the amount the non-user would have been required to pay for such use.[83]

In addition to payments covering fixed charges, each of the parties (shippers) agreed to pay Tapline a pro rata portion of the cost of operation, maintenance, and management of the line. This was to be a per-barrel charge based on the quantity of oil transported. However, the aggregate liability of the parties (shippers) for fixed charges and the per-barrel charges for operation and maintenance were to be finally determined on the basis of the amounts that were allowable as deductions from gross income for Federal income tax purposes.[84]

As noted above, work on the line had begun in 1947, and when Jersey and Socony took up their shares, in December 1948, [85] the construction of the line was well under way. It was completed in 1950 at a cost in excess of $200 million, and the first deliveries of crude through the line were made at Sidon, Lebanon (the Mediterranean terminal), in December, 1950.[86]

The off-take agreements.—At the time Jersey Standard and Socony made the Aramco and Tapline agreements, they also made a series of agreements with Aramco and Caltex Oceanic, Ltd. (a marketing subsidiary of Standard of California and Texas Co.) respecting the distribution of the crude and refined products produced by Aramco. One agreement known as the off-take agreement,[87] set up a schedule

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[78] Articles of incorporation of Trans-Arabian Pipe Line Co., as amended, June 30, 1947.

[79] The loan was to be obtained from a group of insurance companies and was to enable Tapline to start construction on a pipeline to run from Aramco's oil fields in Saudi Arabia to the Mediterranean, a distance of 1,050 miles. It was to be a large diameter line, 30-31 inches, with a capacity of 300,000 barrels per day. Work on the line began in 1947 and it was completed in 1950.

[80] Pipeline agreement, March 12, 1947, among Trans-Arabian Pipe Line, Standard Oil Co. (New Jersey), Socony-Vacuum Oil Co. Inc., Standard Oil Co. of California, and the Texas Co.

[81] Pipe line agreement, ibid.

[82] Fixed charges meant all charges which did not fluctuate in proportion to through-put, including depreciation, interest on borrowed capital, taxes, right-of-way rentals, etc. See article IV of pipeline agreement, op. cit.

[83] Ibid.

[84] Article V of pipeline agreement, op. cit.

[85] Letters from B. E. Hull of Trans-Arabian to Standard Oil Co. (New Jersey) and Socony-Vacuum Oil Co., Inc., December 2, 1948.

For their Trans-Arabian shares Jersey paid $25,000 (250 shares) and Socony $8,333.33 (83⅓ shares).

[86] World Petroleum, January 1951, p. 30.

[87] Off-take agreement between Aramco, Jersey, Socony, and Caltex Oceanic, Ltd., March 12, 1947.

of "annual minimum" quantities of crude which each of the parties would take (buy) from Aramco over a period of 18 years. Deliveries were to begin when the pipeline (Tapline) was completed. In the event, however, that Jersey and Socony stock subscription agreements with Aramco and Tapline were terminated, the off-take agreement also would be dissolved. The "annual minimums" were each owner's pro rata share of Aramco's annual production, which was set at 380,000 barrels per day in the first year and increased to 500,000 barrels in the 18th year.[88] There were, however, options given which enable an owner (buyer) to obtain oil in excess of the annual minimum.

The prices which the buyers (owners of Aramco) were to pay Aramco for crude and refined products were to be determined by Aramco's board of directors—

> * * * in accordance with the principle that seller (Aramco) should be run for its own benefit as a separate entity.[89]

Prices were to be the same to all buyers (owners) and price differentials for deliveries at different places or under different conditions were to be so fixed as to cause no discrimination between buyers. However, if any buyer (owner) did not take its "annual minimum," as stated in the agreement, any buyer taking the excess quantity would be granted a credit, which had the effect of reducing his average annual price. Apparently this was a premium granted to a buyer for maintaining Aramco's production at the agreed levels. Conversely, it also could be considered a penalty upon those buyers who did not take their "annual minimums," for the price concession or credit was granted for taking excess quantities above "annual minimums" only in periods when another buyer or buyers took less than its (their) "annual minimum." [90]

There could be no assignment of rights under the off-take agreement without the approval in writing of the other parties, except to a corporation that was wholly owned by one or more of the parties to the agreement. Thus, if an outsider (nonowner) wished to purchase any crude or refined products produced by Aramco, such purchases had to be made from the owners and not directly from Aramco.[91]

But apparently Jersey and Socony did not wish to wait until the pipeline was completed before they could share in Aramco's output, for at the same time the off-take agreement was signed (March 12, 1947), the same parties concluded an interim off-take agreement,[92]

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[88] With the completion of Tapline in late 1950, this agreement is now in effect unless it has been revised. Apparently the parties underestimated demand or the potentialities of Aramco to produce, for in April 1951, Aramco was producing in excess of 600,000 barrels per day.

[89] Off-take agreement, op. cit., art. IV.

[90] The provision reads as follows: "Each buyer shall be entitled to be credited with any amount by which the price of the 'excess quantity' taken by it during the year (computed at the average price per barrel of all crude oil purchased by such buyer hereunder in said year) exceeds the sum of (1) seller's cost of production of such quantity in said year (such cost of production to be determined as provided in article V hereof) and (2) 15 cents per barrel. 'Excess quantity' as used in the preceding sentence means the quantity which represents (1) a percentage of such buyers annual minimum equal to the excess of the percentage (not over 100 percent) of its annual minimum taken by it over the percentage of annual minimum taken by the buyer taking the smallest percentage of its annual minimum (2) multiplied by the quantity of its annual minimum." (From off-take agreement op. cit., art. IV.) The cost of production (in art. V) was to be determined by independent certified public accountants (selected by seller and buyers) in accordance with seller's accounting policies and procedures as prescribed from time to time by seller's board of directors. (From off-take agreement, art. V.)

[91] During the early stages of the negotiations between the parties, Standard of California indicated a willingness to consider insertion of a provision in the agreements to the effect that Aramco would sell only to its stockholders. Socony favored such a provision but Texas, subject to further consideration, objected. However, Jersey believed Aramco should sell only to stockholders and that all such sales should be made at the same price. (Memorandum Regarding Drafts of Aramco Agreements, November 21, 1946, and Memorandum Regarding Status of Aramco Agreements, December 3, 1946, both prepared by George Koegler).

[92] Interim off-take agreement, March 12, 1947, between Aramco, Jersey, Socony, and Caltex Oceanic, Ltd.

which permitted Jersey and Socony to purchase crude and refined products from Aramco in 1947, 1948, and 1949.[93] Beginning with August 1947, and continuing through 1949, Jersey and Socony were also permitted to purchase specified quantities of crude or refined products left over after Caltex had satisfied its requirements.[94] Prices under this agreement were to be established in the same manner as in the off-take agreement, i. e., by Aramco's board of directors. The interim agreement was to remain in effect until the off-take agreement became effective. But, in the event the off-take agreement was not in effect by January 1, 1950, and Jersey and Socony had not purchased their shares in Aramco,[95] they were to continue to make purchases from Aramco:

> * * * *in such quantities, for such period of time, and on such terms and conditions as shall be mutually agreed upon.* [96]

Evidently Jersey and Socony wished to maintain their relationships with Aramco as long as possible, or, at least until the ownership question was resolved.

In both the off-take and the interim off-take agreements, the parties [97] signified their intentions to enter into a processing agreement which would set forth the conditions and terms for processing crude at Aramco's large refinery at Ras Tanura.[98] On December 31, 1947, the parties, in lieu of the processing agreement, formally recorded the arrangements which would govern the distribution (sharing) of the output of this refinery among the parties (owners) in an agreement called the refined-products offtake agreement.[99]

The agreement, relating to the sharing of the refinery's output, was to become effective January 1, 1948. It was similar in many respects to the other off-take agreements.[1] Each party was given an option to purchase its percentage of the output of the refinery after deducting what Aramco needed to meet local requirements.[2] If a party did not take (purchase) its full share of the output of the refinery in any 6 months' period beginning with January 1, 1948, the parties taking their full percentages were given the option of purchasing the output not taken by other parties.[3]

Payments to Aramco were divided into two categories. First, as consideration for the options to share the output of the refinery according to percentage of ownership, the parties agreed to pay Aramco annually their pro rata share of Aramco's fixed charges (less the percentage allotted to cover local requirements) plus $2 million.[4]

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[93] Jersey's schedule of quantities began with 12,000 barrels daily in August 1947 and increased to 25,000 barrels in 1949. Socony's quantities were 13,100 barrels daily in August 1947 and increased to 16,000 barrels in 1949. No specific effective date was given in the agreement but evidently it was August 1947.

[94] Arts. I and II of interim off-take agreement.

[95] This was contingent, of course, upon a settlement of the red-line question.

[96] Art. VII of interim off-take agreement. [Italic added.]

[97] The parties were Aramco, Jersey, Socony, and Caltex Oceanic, Ltd.

[98] This refinery had a capacity in excess of 100,000 barrels per day in 1947. (See Texas Co. Prospectus, September 17, 1947, p. 11.)

[99] The parties to the refined-products offtake agreement were the same as to the other offtake agreements, i. e., Aramco, Jersey, Socony, and Caltex Oceanic, Ltd.

[1] A party could not assign its rights under the agreement without the approval in writing of the other parties, except to a corporation that was 100-percent-owned by one or more of the parties. Aramco was not to discriminate in any manner, among the parties. If Jersey and Socony's stock subscription agreements were terminated, the refined products off-take agreement would also terminate.

[2] Included in the deductions to meet local requirements were the products Aramco provided free of cost to the Saudi Arabian Government, products consumed by Aramco in its own operations, products supplied Tapline for its own use, and products sold by Aramco for local consumption within Saudi Arabia. (Art. I of the refined products off-take agreement.)

[3] Rules for sharing these purchases proportionately were set out in the agreement.

[4] Art. IV of agreement. The sum of $2 million was subject to increase or decrease at the beginning of each year by Aramco's board of directors.

Adjustments in each party's pro rata share of these payments were to be made to correspond to the quantities of products taken. Secondly, as a price for the refined products purchased, each party was to pay to Aramco its pro rata part of the value of crude used in producing the refined products. The value of the crude was to be computed at the price established for this crude by Aramco's board of directors as provided in the off-take and interim off-take agreements.[5] In addition, the parties were to pay all of Aramco's direct expenses due to operation and maintenance of the refinery, plus an amount equal to 10 percent of such expenses.[6]

The three off-take agreements discussed above were essentially the working rules for sharing the output and distributing the costs of Aramco among its respective owners. It was the intention of the parties that Aramco should earn profits, but the amount of these profits depended largely upon what Aramco's board of directors thought they should be. This board, composed of representatives of the owning (buying) companies, determined the price to be paid Aramco for crude, and the crude price, in turn, fixed the prices to be paid for refined products.[7] Although the parties were to pay other charges and sums to Aramco, Aramco's principal source of income was to be the sale of crude oil and petroleum products at prices fixed by its own board. The apparent ability of the buyer-owners to determine, themselves, Aramco's profits could be a factor of considerable significance in view of the fact that under the 1950 concession agreement payments to the Saudi Arabian Government were to be determined by Aramco's profits.

Aramco's 1950 concession agreement with the Saudi Arabian Government.—On December 30, 1950, Aramco and the Saudi Arabian Government agreed to a revision of the 1939 concession agreement. The important change related to tax payments to be made by Aramco to the Government. During 1950, the Saudi Arabian Government issued two income tax decrees which, for the first time, imposed income taxes on petroleum producers. In effect, the income taxes which were imposed, together with royalties and other payments to the Government, amounted to 50 percent of Aramco's profits after allowing for income taxes paid to other countries. Aramco agreed to pay taxes up to but not exceeding 50 percent of its net profits, after income taxes to the United States were deducted. It was on this basis that a new agreement was concluded. In return for the additional payment, Aramco was permitted to pay taxes in any currency which it received and in the same proportions as received, and to obtain Saudi Arabian riyals (the local currency) at the prevailing rate of exchange rather than at a premium.[8]

The new agreement was retroactive to January 1, 1950, and according to press reports, Aramco was required to pay the Saudi Arabian

[5] See previous discussion of these agreements.

[6] Art. V of the agreement.

[7] Jersey Standard's interest in Aramco's operation and the price for Aramco crude is shown by the following quotations from a letter from Orville Harden to Eugene Holman, May 5, 1947. Mr. Harden pointed out that it would not be practicable for him to attend the Aramco board meeting in San Francisco on the week of May 19 and that he was sorry to miss it for there were two matters that were of great importance. "*One is the question of establishing a procedure to assure of giving the Aramco management, in meeting its problems, the maximum benefit of Jersey's experience and knowledge.* * * *"

"*The other is the question of price for crude. It is essential to get this on a proper basis at the very beginning.* After our own Board has reached a conclusion, it might be desirable for you or you and Brewster to have a talk with Rogers in New York. * * *" (Brewster was Brewster Jennings, president of Socony-Vacuum, and Rogers was W. S. S. Rogers, chairman of the board of Texas Co.) [Italics added.]

[8] From Annual Reports to Stockholders 1950, of Standard Oil Co. (New Jersey), Standard Oil Co. of California, Socony Vacuum Oil Co., Inc., and the Texas Co.

Government an additional sum of approximately $30 million for the year. No changes were made in the per ton royalty payment, which, in 1950, was equivalent to approximately 34 cents per barrel.[9]

KUWAIT OIL CO., LTD.

Introduction.—Gulf Exploration Co., a subsidiary of Gulf Oil Corp., and Anglo-Iranian Oil Co., each owns a 50-percent share of the stock of Kuwait Oil Co., Ltd., an operating company registered under British laws. The latter holds an exclusive concession to explore for and produce oil in the entire 6,000 square miles of territory constituting the independent Sheikdom of Kuwait on the west coast of the Persian Gulf. The Sheik of Kuwait rules this area under British protectorate and has treaties and agreements with Great Britain giving preference to British subjects or companies of British nationality respecting exploration for and production of oil in Kuwait. The Kuwait concession is for 75 years beginning on December 23, 1934, and covers all of Kuwait, representing an area of about 3,900,000 acres. The one field so far developed at Burgan has been estimated by Gulf to contain at least 10 billion barrels of oil, of which Gulf's half would be some 5 billion barrels in this one field in Kuwait. In 1946, Gulf estimated that in other areas it controlled something less than 2 billion barrels.

This section of the report will describe the setting up of Kuwait Oil Co., Ltd., as an operating company jointly owned by British and American private interests in accordance with (*a*) the international agreements between the British Government and the Sheik, (*b*) the British Government's policy of giving preference to British nationals in British territories and protectorates,[10] and (*c*) private cartel agreements among the principal international oil companies in effect at the time.

International background.—The political history of conditions leading up to the 50-percent interest held by Gulf Exploration Co. in Kuwait Oil Co., Ltd., goes back as far as 1899, the year in which Mubarak-al-Subah, Sheikh of Kuwait, agreed with Her Britannic Majesty's political resident in the Persian Gulf, that he:

> * * * of his own free will and desire does hereby pledge and bind himself, his heirs and successors not to receive the Agent or Representative of any Power or Government at Koweit, or at any other place, within the limits of his territory, without the previous sanction of the British Government; and he further binds himself, his heirs and successors not to cede, sell, lease, mortgage, or give for occupation or for any other purpose any portion of his territory to the Government or subjects of any other Power without the previous consent of Her Majesty's Government for these purposes. This engagement also to extend to any portion of the territory of the said Sheikh Mubarak, which may now be in the possession of the subjects of any other Government.[11]

Fourteen years later, in 1913, Sheikh Mubarak laid the basis for Britain's claim to Kuwait oil by agreeing to show a British Government representative:

> * * * the place of bitumen in Burgan and elsewhere and if in their view there seems hope of obtaining oil therefrom we shall never give a concession in

[9] The Journal of Commerce, New York, January 3, 1951.
[10] The general facts respecting the organization of the Kuwait Oil Co., Ltd., and the sharing of ownership between Gulf and Anglo-Persian are well known, and the treaties and the agreements between the Sheik and His Majesty's Government are matters of published information. The various contracts and agreements by which all of these parties gave consent to and established the legal status of the jointly owned company, however, have been quite closely guarded secrets.
[11] C. U. Aitchinson's Treaties, Engagements, and Sanads, vol. XI, fifth edition (1929), p. 262.

this matter to anyone except a person appointed from the British Government.[12]

Similar agreements negotiated by the British Government with other sheiks and rulers in the Arabian Peninsula were part of the steps by which the British sphere of interest was built up in the Near and Middle East.[13] They became the basis upon which the British Government later based its policy of insisting that the rulers of these independent states give preference to British interests in the granting of oil concessions. Under this preference, commonly referred to as the nationality rule, Eastern and General Syndicate, Ltd., a British company headed by Maj. Frank Holmes, later negotiated with various local rulers for concessions. In 1925, such a concession was obtained covering part of Bahrein Island. Others for which negotiations were started included all or part of Kuwait. It should be noted that options on both of these concessions were first offered to Anglo-Persian Oil Co., which rejected them.

When Gulf Oil Corp. first sought to obtain a foothold in the Near East, British geologists had reported adversely on the Bahrein concession. Nevertheless Gulf's subsidiary, Eastern Gulf Oil Co., entered into an agreement with Eastern and General Syndicate, on or about November 50, 1927, under which Eastern Gulf Oil Co. obtained an option on certain oil concessions then held or yet to be negotiated by Eastern and General Syndicate, Ltd., in Bahrein Island and Kuwait.

At the time these options were taken, Gulf Oil Co. was one of the group of American companies that was negotiating for a participation in Iraq Petroleum Co. (IPC), but the red-line agreement of 1928, requiring all IPC participants not to act individually in an area including most of the old Turkish Empire and all of the Arabian Peninsula, had not yet been signed. Late in 1928, however, when Gulf proposed to take up its option on Bahrein, approval by IPC was necessary under the red-line agreement. Backed by the unwillingness of the British Government to have an American company obtain a foothold in the area, IPC decided that, as a participant in the red-line agreement, Gulf could not exercise its option. Thereupon, Gulf transferred its Bahrein option to Standard Oil of California on December 21, 1928, and, at that time or soon thereafter, withdrew from its participation in IPC. Gulf, however, retained its option with Eastern and General Syndicate, Ltd., for the Kuwait concession.[14]

In 1931, when Eastern Gulf Oil Co., acting as an independent American oil company no longer participating in IPC and the red-line agreement, sought to take up the Kuwait option through Eastern and General Syndicate, opposition again arose from both British oil interests and the British Government. The British Colonial Office, in accordance with its long-time policy respecting British colonies and protectorates, insisted that only a British subject or firm should be given the concession. Gulf thereupon brought the matter to the attention of the United States Department of State, which, through the American embassy in London, requested equal treatment of Ameri-

12 Ibid., pp. 264–265.

13 Other independent Arab States with which Britain has similar treaties include: Bahrein, Oman and Trucial Oman, all on the Persian Gulf and Gulf of Oman, and Saudi Arabia.

The area referred to as the Arabian Peninsula includes the Kingdom of Saudi Arabia, Yemen, the British Crown Colony of Aden, and the Sheikdoms and Sultanates of Hadramaut, Muscat, Oman, Trucial Oman, Qatar, Kuwait, and Bahrein Island.

14 American Petroleum Interests in Foreign Countries, op. cit., p. 313. For further details regarding the Bahrein concession, see p. 71.

can firms under the open-door policy. The ensuing negotiations were complicated by the fact that Anglo-Persian, which had previously expressed disinterest in Kuwait, also opened negotiations with the Sheikh of Kuwait for a concession. The Sheikh thus found himself confronted by two bidders.[15]

The Anglo-Persian, Gulf Exploration Co. agreement, December 14, 1933.—After 3 years of negotiations involved in this competitive struggle for the yet-undiscovered Kuwait oil, Anglo-Persian and Gulf decided to make common cause in endeavoring to secure one or more concessions in Kuwait, which they would operate jointly. On December 14, 1933, they accordingly entered into an agreement:

1. To exercise Eastern Gulf Oil Corp.'s option on any concession or concessions which Eastern and General Syndicate might obtain in Kuwait;
2. To use the agencies and facilities at the disposal of each to obtain these concessions on terms not substantially more onerous to the concessionaire than those of a draft concession which, by reference, was made part of the agreement;
3. To assume on a 50-50 basis any expenses subsequently incurred by either party in obtaining these concessions, including a cash payment of £36,000 due to Eastern and General Syndicate if and when Eastern Gulf Oil Co. took up its option with the syndicate;
4. To form an operating company (Kuwait Oil Co., Ltd.) to be financed and owned equally by Anglo-Persian Oil Co., Ltd. and Gulf Exploration Co., whose production would be shared equally by Anglo-Persian and Gulf at cost, the ownership of which could not be sold or transferred except (*a*) with the consent of the other party and (*b*) subject to the provision that any transferee would become fully bound by the terms of the 1933 agreement.[16]

Two other important provisions relating to the disposal of oil which the Kuwait Oil Co. might produce in the future were covered by the agreement. In the first place, each gave assurance to the other that Kuwait oil would not be used to "upset or injure" the other's "trade or marketing position directly or indirectly at any time or place." In the second place, each party undertook "to confer from time to time as either party may desire and mutually settle in accordance with such principles any question that may arise between them regarding the marketing of Kuwait oil and products therefrom." It was further stipulated that Anglo-Persian's marketing position in India as a supplier of Burmah Oil Co. was recognized even though its marketing position:

> * * * is on an in and out nature dependent on the relation from time to time between Burmah Oil Co.'s and/or the Burmah-Shell Co.'s outlet there and the volume of indigenous production * * * even though in pursuance of such arrangement it [Anglo-Persian] may not at any given time actually be supplying oil or the full range of its products to that market.

Notwithstanding these restrictive provisions, the agreement stated:

> Anglo-Persian recognized, however, that Gulf will wish to have outlets for Kuwait oil, if and when produced; and therefore has no desire that Gulf should

[15] The reason for Anglo-Persian's sudden change of interest appears to have been the discovery by Standard Oil Co. of California of oil in quantity in nearby Bahrein in an area previously considered by British geologists to be unfavorable to oil production.

[16] Specifically, the agreement was that if either party proposed to sell or transfer his interest in whole or in part to a third party, all the facts as to purchaser, price, etc., had to be reported to the other party who then had the option of approving the sale or of buying the shares at the price offered by the third party. Only if the other party was willing neither to approve the third party nor to buy the shares at the price offered by the third party, could the sale or transfer to an outsider be completed without the consent of the other party.

assume any restrictions with respect to the marketing of such oil products therefrom which would in any way interfere with Gulf's freedom to obtain such outlets consistently with the observance of the above assurance.

Thus, Anglo-Persian assured Gulf that it would have freedom to seek markets for Kuwait oil, while both bound themselves not to compete with each other in such a manner as to endanger each other's marketing position. These provisions were entirely consistent with the international cartel agreement, heads of agreement for distribution, which had been formulated with the participation of Gulf and which was then in effect. Under this agreement the market positions of all participants were to be determined on the basis of their 1928 "volume of business and their proportion of any future increase in production," [17] and quotas so determined were to apply in every country of the world except the United States.[18]

In entering into this agreement Gulf, which had a "recognized marketing position" in European and Western Hemisphere foreign markets, but none in the Far East, was seeking a Middle East source of supply under its own control. If it obtained such a source free from restrictions on its sale of Kuwait oil, not only would its competitive position be greatly strengthened in European markets, but also it would be able to enter the Far East markets. Naturally Gulf wished to retain these advantages. It declare in an application to the Securities and Exchange Commission, in 1946, that the restrictive marketing provisions were obnoxious to both Gulf Exploration Co. and its parent company.[19]

On the other hand, as noted in a subsequent chapter, Gulf had participated in the formulation of the world cartel's heads of agreement for distribution. Hence, the company was fully aware of the cartel's attempt to divide world markets on the basis of the percentages of trade done in each market in 1928.[20] Its participation in the formulation of the cartel agreement obviously weakened Gulf's position in resisting the marketing restrictions insisted upon by Anglo-Iranian, which were based on the cartel agreement itself. Thus even though Gulf had the support of the United States Department of State's "open-door policy," it was virtually compelled to accept various restrictive conditions. Gulf's counsel has stated that further efforts were made to have the British Government modify or remove these restrictions but without success.[21] Gulf was also obliged to accept a condition, insisted upon by the British Government, that only a British company could hold a concession to produce Kuwait oil.[22]

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[17] Principle No. 1 of the Achnacarry Agreement of 1929. See pp. 200 and 242.

[18] Furthermore, before Anglo-Persian Oil Co., Ltd., would sign the Kuwait agreement with Gulf Exploration Co., Gulf Oil Corp. was required to sign a subsidiary agreement, also dated December 14, 1933. This agreement, which was comparatively short, merely stated that in view of Anglo-Persian entering into the main agreement with Gulf Exploration Co., and of Gulf Oil Corp. procuring Gulf Exploration Co. to enter into the main agreement, the two parent companies bound themselves and each of their respective subsidiary and associated companies directly or indirectly under their control to observe two paragraphs of the main agreement. These were respectively par. 3 which provided that any concession obtained in Kuwait by either party, either singly or jointly, would be held in trust for the benefit of both parties, and par. 7 which eliminated competition between the parties in marketing Kuwait oil as already described.

[19] Gulf's application for Nondisclosure of Certain Documents, filed with the Securities and Exchange Commission October 31, 1946, p. 4.

[20] See p. 241 ff.

[21] Gulf's application to the Securities and Exchange Commission, p. 7.

[22] It appears that the British Government's part in the matter first took the form, in 1929, of notifying Eastern and General Syndicate that any concession it obtained would have to go to a concessionaire bound at all times to be and remain a British company, and of insisting that other restrictive provisions intended to keep American interests out be written into the concession agreement. (For the basis for such insistence, see treaty agreements with the Sheik quoted on p. 129.)

Later, but only following representations by the United States Department of State in 1932, His Majesty's Government modified its position to the extent of waiving the nationality clause in the concession, but stood by its requirement that the concessionaire must be and always remain a British company.

Operation of Kuwait Oil Co.—Paragraph 6 of the joint ownership agreement of December 14, 1933, between Gulf Exploration Co. and Anglo-Persian stated that the quantity of oil to be produced by Kuwait Oil Co., Ltd., would be determined as follows:

1. Either party would have the right to require Kuwait Oil Co., Ltd., "to produce such quantity of crude oil as may be decided by the party making the request;"

2. That all production from Kuwait produced at the request of both parties would be allocated "50–50 to Gulf and Anglo-Persian at cost;"

3. That any additional oil produced at the request of either Gulf or Anglo-Persian would "be allocated in full to the party making the request, at cost for all such oil." [23]

In addition, section 8 of the agreement stated:

> The parties have in mind that it might from time to time suit both parties for Anglo-Iranian to supply Gulf's requirements from Persia and/or Iraq in lieu of Gulf requiring the company to produce oil or additional oil in Kuwait.
>
> Provided Anglo-Persian is in position conveniently to furnish such alternative supply, of which Anglo-Persian shall be sole judge, it will supply Gulf from such other sources with any quantity of crude thus required by Gulf provided the quantity demanded does not exceed the quantity which in the absence of such alternative supply Gulf might have required the company to produce in Kuwait—at a price and on conditions to be discussed and settled by mutual agreement from time to time as may be necessary—such price f. o. b., however, not to be more than the cost to Gulf of having a similar quantity produced in and put f. o. b. Kuwait.

Thus Gulf and Anglo-Persian could order jointly or separately as much oil out of Kuwait as either desired. The above provisions, however, gave Anglo-Persian a powerful voice in determining the actual amount of Kuwait production. Anglo-Persian, having extensive interests in Iran and Iraq, could determine for itself how much of its own requirements would be ordered from Kuwait rather than from Iran and Iraq. Whenever convenient, moreover, a matter of which it was the sole judge, Anglo-Persian, in consultation with Gulf, could decide that part or all of the oil ordered out of Kuwait by Gulf would actually be produced by Anglo-Persian in either Iran or Iraq or both. The provision that such alternative oil would not cost Gulf more than if it had been "produced in and put f. o. b. Kuwait" made it a matter of indifference to Gulf, insofar as price was concerned, whether Kuwait oil or "alternative oil" were actually supplied.

Anglo-Persian's power to substitute, with Gulf's consent, alternative oil for increased Kuwait output accorded perfectly with the principles of the international cartel agreement of 1928, commonly known as the Achnacarry agreement. Under that agreement the major international oil companies, including Anglo-Persian, endeavored to control production by such means as (1) joint use of existing facilities, (2) constructing only such additional facilities as were necessary to supply increased demand, and (3) shutting in any excess of production over consumption. If and when Kuwait produced oil, it would of course become a new source of supply in the international market. Some means of controlling its production by the substitution of oil from other established producing regions would be a logical cartel objective under these principles. The substitution of Persian or

[23] "Cost" was defined as the actual out-of-pocket expenses incurred by the company, including exploration, drilling, royalties, duties, taxes, and all other expenses whatsoever applicable to such oil, and depreciation, amortization, and interest on capital at reasonable rates to be agreed upon.

Iraq oil would constitute a use of existing facilities and, in effect, be equivalent to shutting in an equal quantity of Kuwait oil.

Reiteration of restrictive clauses in 1937.—By agreement dated March 23, 1937, the 50-percent stock interest in Kuwait Oil Co., Ltd., consisting of 100,000 shares of £1 par value owned by Anglo-Iranian Oil Co., Ltd. (formerly Anglo-Persian) was transferred to the latter's wholly owned subsidiary, D'Arcy Exploration Co., Ltd.[24]

The effect of this 1937 agreement was to reaffirm all of the provisions of the main agreement of 1933 and to continue the restrictive provisions respecting marketing and the substitution of oil from other sources for Kuwait oil. Gulf Oil Corp. has stated that the restrictive provisions always were objectionable, and that it originally consented to these provisions in 1933 and continued to do so in 1937 only because of the insistence of the Anglo-Iranian Oil Co., Ltd.[25]

Postwar development.—Operations in Kuwait were entirely suspended in 1942, and were not resumed again until after the war. Transportation and loading facilities were completed and commercial shipments began about August 1946, with Gulf selling its share of Kuwait production to Asiatic Petroleum Co., a subsidiary of the Royal Dutch-Shell. In 1946, Gulf Oil Corp. stated that Anglo-Iranian was advised of this sale and raised no objection.[26]

In May 1947, Gulf Exploration Co. entered into a long-term contract to sell much larger quantities of its share of Kuwait oil to the Shell Petroleum Co., Ltd., of London, England, another Royal Dutch-Shell subsidiary. This commercial contract, which is of the type commonly referred to in the trade as "sale of oil agreements" is discussed in the following chapter.

SUMMARY

When Standard Oil Co. of California and Gulf Oil Corp. first began negotiations to obtain concessions in Saudi Arabia, both were practically newcomers in the world oil trade and both were acting outside the closely cooperating group of international oil companies that controlled Middle East production. The older companies first tried to prevent Gulf and Standard of California from obtaining concessions, and when this failed, attempted to devise other means of preventing the newly discovered oil from disturbing world markets. The history of the development of Aramco and Kuwait Oil Co., Ltd., therefore, is a history of the difficulties faced by independent American interests in obtaining a foothold in the Middle East and of finding a market for flush production.

Aramco.—In winning an exclusive concession covering an area of about 360,000 square miles in Saudi Arabia, Standard Oil Co. of

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[24] In making this transfer, the various companies made the following agreements having to do with the continued observance of the main agreement of December 14, 1933, between Anglo-Persian Co., Ltd., and Gulf Exploration Co.:

1. D'Arcy Exploration Co., Ltd., agreed to become bound by all terms of the main agreement upon the transfer, and Gulf Oil Corp. and Gulf Exploration Co. agreed to continue to be bound by all terms of the main agreement after the transfer.
2. Anglo-Iranian Oil Co., Ltd., agreed to continue to be bound by and observe the provisions of clauses 3, 7, and 8 of the main agreement of December 14, 1933.

Clause 3 provided that any concession obtained in Kuwait by either party would be held in trust for the benefit of both parties; clause 7 provided that neither party would use Kuwait oil to encroach on the marketing position of the other directly or indirectly at any time or place; and clause 8 covered the substitution by Anglo-Persian of oil produced in other areas for oil which Gulf had the right to demand from Kuwait.

It was also mutually agreed that the 1937 "supplemental agreement" would be binding upon and accrue to the benefit of all of the parties and their respective permitted successors and assigns.

[25] The Anglo Persian-Gulf Exploration Co. agreement of December 14, 1933, was canceled in an agreement dated November 30, 1951; see p. 141, footnote 17.

[26] Gulf's application to the Securities and Exchange Commission, loc. cit.

California faced the competition of Iraq Petroleum Co. representing the combined interests that controlled all production in Iraq and Iran, as well as in most of the remainder of the Middle East. To obtain the concession California Standard agreed to make loans and advances to the Arabian Government in the amount of £150,000; to pay annually a cash rental of £5,000; and if oil were discovered, to pay a royalty of 4s. per ton and to furnish free to the Saudi Arabian Government 200,000 gallons of gasoline and 100,000 gallons of kerosene, annually. Further advances of £100,000 and an increase in the annual rental of £20,000 was the price for obtaining a second concession in 1939 which extended the concession area to 440,000 square miles. The loans and cash advances were recoverable by the company only by deductions from royalties, and the Government also hoped to augment its income through royalties. From the outset, therefore, Aramco's financial relationships with the Saudi Arabian Government required a market outlet for any oil discovered.

With no established position in the Eastern Hemisphere, Standard of California had already come face to face with the difficulty of finding a market for its Bahrein oil without engaging in a competitive struggle with the established international companies. The Bahrein problem was solved on July 1, 1936, when Standard of California bought a half interest in the far eastern marketing facilities of the Texas Co., which already had an established position east of Suez, with the Texas Co. buying a half interest in the Bahrein Petroleum Co. Aramco also obtained access to these limited eastern markets when the Texas Co., in December 1936, bought a half interest in Aramco. A trade press comment at the time of the first acquisition stated that—

> * * * it assures that Bahrein production as well as any output that may eventually come from countries now being developed by Standard Oil Co. of California will have assured and regulated outlets and will so lessen any possible danger of upsetting the equilibrium of international markets.[27]

Up to 1941, Caltex, the marketing company owned jointly by Standard of California and Texas, was able to find markets east of Suez for only 12,000 to 15,000 barrels daily of Aramco's oil. This was reported to be less than one-seventh of what Aramco's developed fields could have produced in 1941. During the war, production was gradually increased to 58,386 barrels daily in 1945. Since a large proportion of this output, however, was refined and sold to the Allied Governments, this proved to be only a temporary outlet, leaving Aramco at the end of the war with crude oil and refining facilities, but no market. Moreover, Aramco's need for markets was aggravated by the discovery of additional fields in 1945 and 1947. At this point, Aramco proposed to build a pipeline to the Mediterranean.

This proposal caused great concern to the established international companies, which immediately endeavored to open up additional markets to Aramco, both east and west of Suez, but in such a manner as not to disturb world markets. This involved several coordinated steps. First, the Texas Co. sold its European marketing facilities to Caltex, thus making its markets west of Suez available to Aramco. Second, Standard of California and Texas permitted Standard Oil Co. (New Jersey) and Socony-Vacuum Oil Co., together, to purchase a 40-percent interest in both Aramco and Trans-Arabian Pipe Line

[27] The Petroleum Times, July 4, 1936, p. 8.

Co. And third, Jersey Standard and Socony-Vacuum entered into contracts to buy oil from Aramco. Thus, while new markets were opened up to Aramco, the recognized marketing positions of the international oil companies were preserved. The principal change was a shift in their sources of supply on the part of three of the four American companies which now own Aramco in order to make room for Aramco's production, which they are now in a position to control.

Kuwait Oil Co., Ltd.—The history of Kuwait Oil Co., Ltd., is likewise one of an American company which, single-handed, sought to obtain a foothold in Middle East production. In 1931, both Eastern Gulf Oil Co., a subsidiary of Gulf Oil Corp., and Anglo-Persian, separately, began negotiating for a concession in Kuwait. After about 3 years, during which time oil was discovered in nearby Bahrein, Anglo-Persian and Gulf made common cause to obtain an exclusive concession covering the whole of Kuwait, setting up Kuwait Oil Co., Ltd., on a 50–50 basis to operate the concession.

At the insistence of Anglo-Persian, the contract establishing the operating company contained a provision that neither party would use oil from Kuwait to upset or injure the other's "trade or marketing position directly or indirectly at any time or place," and that they would confer from time to time to settle any questions that might arise between them regarding the marketing of Kuwait oil. In addition, the contract provided that the quantity of oil to be produced in Kuwait would consist of two parts: (1) such quantity as the two owners agreed to produce and share equally, and (2) such additional quantity as either party might order out for its own account. Part or all of the oil, so ordered by Gulf, however, could, by agreement of the parties, actually be supplied by Anglo-Persian "from Persia and/or Iraq in lieu of requiring the company to produce oil or additional oil in Kuwait." Since the cost of such alternative oil to Gulf would be no more than if the oil actually had been produced and delivered in Kuwait, this, in effect, gave to Anglo-Persian a continuing option, subject to Gulf's consent, to control the quantity of oil produced in Kuwait by substituting oil from its other sources.

Although oil was discovered in Kuwait in 1938 and further explorations proving the existence of large reserves continued until 1942, lack of transportation and loading facilities prevented the sale of oil until after the war. The necessary facilities were completed and commercial sales began in August 1946, with Gulf selling its share of Kuwait's production to a Royal Dutch-Shell subsidiary. Nine months later, Shell contracted to take much larger quantities of Gulf's Kuwait oil for a long period of years. The manner in which much of Gulf's share was fitted into the world market under this commercial agreement without disturbing competitive positions is discussed in the next chapter.

CHAPTER VI

JOINT CONTROL THROUGH PURCHASE AND SALE OF OIL IN THE MIDDLE EAST

INTRODUCTION

Throughout the world the Big Seven oil companies transfer large quantities of crude oil and refined products among themselves, through contracts to purchase and sell. When these purchase agreements are discussed publicly by representatives of the petroleum companies, emphasis is usually placed on the ordinary commercial purchase and sale aspect which they share with all other sales contracts. However, since the companies participating in them often are already bound together through joint-ownership arrangements and participate in various production and marketing agreements, purchase and sale contracts among them often lack many of the arm's-length features that characterize ordinary commercial agreements among mutually independent buyers and sellers. Under these circumstances, the sales of oil covered by the contracts can often be utilized as an instrument to divide production, restrain competition in marketing, and protect the market positions both of the buyer and the seller. They determine who may or may not buy crude oil from particular producing properties. They tend to funnel the production from more or less diversified ownerships into the centralized marketing organizations of the large companies. They tend to keep surplus supplies of crude oil out of the hands of independent oil companies. The existence of these contracts in an atmosphere of joint ownership of production and marketing, the long periods for which they run,[1] the manner in which prices are determined under them, and the marketing restrictions often written into them, indicate that they are something more than ordinary commercial purchase and sale contracts.

The present chapter and chapter VII discuss respectively long-term contracts for the purchase of Middle East oil, and long-term contracts for the purchase of Venezuelan oil. The first agreement to be examined is between Gulf and a subsidiary of Royal Dutch-Shell, involving oil produced by Kuwait Oil Co., Ltd., which in turn is jointly owned by Gulf and Anglo-Iranian, as described in the preceding chapter.

GULF-SHELL AGREEMENT, 1947

Source and nature of material discussed.—As has been noted in chapter V, Gulf Exploration Co., a subsidiary of Gulf Oil Corp., on May 28, 1947, entered into a long-term agreement with the Shell Petroleum Co., Ltd., of London, England, a subsidiary of Royal

[1] Because of the long periods for which they run, sales contracts may be substituted for joint ownership of reserves and production. Chapter VII below discusses such an instance in which the total production of important concessions in Venezuela, which are owned by Gulf Oil Corp., is divided exclusively among Gulf, Standard Oil Co. (New Jersey), and Royal Dutch-Shell interests for the full life of the concession.

Dutch-Shell. This agreement covers the sale by Gulf Exploration Co. of oil produced by Kuwait Oil Co., a producing company organized in 1933 on a 50-50 basis by Gulf Oil Corp. and Anglo-Persian Oil Co., Ltd. (now Anglo-Iranian Oil Co., Ltd.). The Gulf-Shell agreement, therefore, relates to Gulf's share of the joint production of the Kuwait Co. At the time it was made it appears to have covered all of Gulf's share.[2]

Nature and effects of the Gulf-Shell agreement of 1947.—Gulf began selling Kuwait oil to Shell as soon as Kuwait Oil Co. began producing at about the middle of 1946. The arrangement under which these sales were made appears to have been temporary, and to have covered only relatively small quantities of oil. However, under a long-term contract, dated May 27, 1947, between Gulf Exploration Co. and the Shell Petroleum Co., Ltd., Shell agreed to buy increasing quantities of oil out of Gulf's share of crude produced by Kuwait Oil Co. during the period from February 1, 1947, to December 31, 1956. Subsequently, this agreement was extended definitely to December 31, 1969, and indefinitely beyond that date through a provision that either party, by giving notice five calendar years in advance, may terminate the contract on December 31, 1969, or at the end of any succeeding calendar year.

The quantities of oil covered by this contract range upward from 15,000 barrels daily, in 1947, to a maximum of 175,000 barrels daily in later years of the contract period. The total quantity for the entire period covers about 1¼ billion barrels of oil, or about one-fourth of Gulf's share of the already-proven Kuwait reserve. If Gulf and Anglo-Iranian share equally any quantity of oil that they jointly order out of Kuwait, the fact that Gulf has agreed to deliver a minimum of 175,000 barrels daily to Shell implies a production of a minimum of 350,000 barrels daily out of Kuwait.[3] The ability of Kuwait Oil Co. to meet such a joint requirement already has been demonstrated; daily production has increased since shipments began on a commercial basis from 30,000 barrels, upon which Gulf's delivery of 15,000 barrels to Shell for 1947 was based, to an average of 242,000 barrels for the year 1949; to 345,000 barrels for 1950; and to 380,000 barrels for the first quarter of 1951.[4] When, as a result of trouble in Iran, Anglo-Iranian needed more oil from Kuwait as a substitute for shrinking Iranian production, Kuwait's daily production was increased sharply to about 500,000

[2] In submitting a copy of the 1947 contract and two subsequent supplemental agreements in response to subpena, counsel for Gulf Oil Corp. declared that the agreement itself is not relevant to the announced purpose of the present investigation; that it is purely a purchase and sales agreement between the two parties; that the agreement does not restrict either Shell's or Gulf Exploration Co.'s right to dispose of Kuwait oil; that it throws no light on the allegation that over a long period of years American petroleum companies operating in foreign countries have entered into restrictive agreements among themselves and with petroleum companies of other nations; and that the disclosure of its terms would be detrimental to both Gulf Oil Corp. and Shell, which have hitherto carefully kept its terms secret. Counsel for Gulf, therefore, requested confidential treatment and prompt return of the documents without any of their contents having being included in any report.

The Federal Trade Commission has examined the Gulf-Shell agreement of May 28, 1947, obtained by subpena, with the Gulf Oil Corp.'s contention as to confidentiality in mind. After careful examination, the Commission has decided that a description of the general nature of this agreement is pertinent to the present investigation made pursuant to the Commission's resolution of December 2, 1949.

It is recognized, however, that full disclosure of the terms of the agreement of May 28, 1947, might be detrimental to the interests of one or both parties. Therefore, these terms are not disclosed. It is a fact, however, that, although its exact terms may not be known to the other international oil companies, the existence of the agreement and the nature of its economic effects are well known in the industry. The Commission finds, therefore, that a discussion of the general nature and economic effects of this particular agreement does not constitute a disclosure of trade secrets or names of customers as prohibited by the Federal Trade Commission Act.

[3] In addition to oil jointly ordered out of Kuwait, both of the parties had the right to order for their separate accounts such additional oil as they desired; see pp. 359-360.

[4] World Petroleum, May 1951, p. 47, and July 1951, p. 24.

barrels in both April and May 1951,[5] and by the middle of July to a reported 650,000 barrels.[6]

It will be remembered that in 1951 Anglo-Iranian still had the option, with Gulf's consent, of controlling Kuwait production by substituting oil from Iran or Iraq for delivery by Gulf to Shell.[7] This option of Anglo-Iranian to substitute oil from other sources was in no way modified by the fact that substitution was working in reverse during the unforeseen emergency in 1951 when Kuwait oil was being substituted for Iranian oil to meet Anglo-Iranian's needs.

Considered merely as a commercial contract for the purchase and sale of oil, the agreement between Gulf and Shell, in and of itself, would not appear to have impaired either Shell's right to dispose of the oil in any way it sees fit or Gulf's right to dispose of additional Kuwait oil as it sees fit. Actually, however, this apparent freedom is limited in at least three respects: (1) if Gulf, using Kuwait oil or any other oil, should cut prices or cause price cutting in any attempt to increase its business in any Eastern Hemisphere market, Gulf would thereby not only receive less for its own sales of oil, but also, under the terms of the agreement, would receive a lower price on its sales to Shell; (2) under the agreement, Gulf's deliveries to Shell would be reduced, should Gulf, through the use of Kuwait oil, increase its business at Shell's expense; and (3) Shell's marketing activities were already restricted because of certain other relationships among Shell, Anglo-Iranian, and other international oil companies.

Under the pricing terms of the Gulf-Shell contract, Gulf became mutually interested with Shell in the profitable marketing by Shell of large quantities of Kuwait oil over a 22-year period. These terms provided for the sharing of profits between Gulf and Shell under an intricate formula for calculating the amount of profits realized on the production, transportation, refining, and marketing of the oil sold to Shell.[8] For the purposes of the contract, the parties assumed that a representative proportion of the volume of Shell's sales in each of the "listed territories" named in the contract would be derived from Kuwait oil. It was stated in the contract that Shell was not bound, in fact, to market the indicated amounts of Kuwait oil in each of these "listed" marketing territories which includes practically all petroleum markets in the Eastern Hemisphere.[9] In assuming that Shell would distribute its Kuwait oil in each of these markets, it was also assumed that Shell would incur certain costs of transportation, refining, and marketing, and that Shell's total receipts from the sale of the oil would likewise reflect this pattern of distribution. By subtracting Shell's assumed costs and the actual costs of production and delivery incurred by Gulf from Shell's assumed receipts, an annual profit, or loss, figure would be determined. It was agreed that this profit would be shared equally by Gulf and Shell.

Thus, Gulf did not receive a stated price for its oil,[10] but instead received a 50-percent financial interest in Shell's disposition of that

[5] Platt's Oilgram News Service, July 2, 1951, p. 3.
[6] Journal of Commerce (New York), July 20, 1951, p. 1.
[7] This is further evidenced in the Gulf-Shell agreement by the statement that Gulf's obligations are subject to the agreement of December 14, 1933, between Anglo-Persian and Gulf.
[8] More than half of the approximately 170 printed pages constituting the Gulf-Shell contract are devoted to "schedules" setting out the complicated statistical and accounting procedure by which the profits to be divided between Gulf and Shell are to be determined.
[9] For further comment on this point, see p. 140, footnote 12.
[10] The contract states that the price formula was agreed upon because there was no published market price for crude oil in the Persian Gulf and the parties could not agree upon a stated sum per barrel for the duration of the contract.

oil. This price was contingent upon the prices received by Shell in its marketing territories described above. Gulf, therefore, received through this contract a direct interest in Shell's marketing activities in the Eastern Hemisphere and in the maintenance of the prices received by Shell marketing subsidiaries and joint marketing organizations. If Gulf were to invade those markets and establish a marketing position at the expense of companies other than Shell and were to thus depress prices, it would receive a lowered price not only on its own sales, but also on its sales to Shell, since Shell's profits would be thereby also lowered.

In addition to this general restriction on Gulf, flowing from its acquired interests in successful marketing by Shell of its Kuwait oil, the Gulf-Shell contract specifically provided penalties on Gulf should Gulf take any business away from Shell in any Eastern Hemisphere market. Clause 6, paragraph (6) (a) of the Gulf-Shell contract states:

> If any Gulf company should in any year of the delivery period except the last year of that period through its utilization of Kuwait crude oil increase its proportion of the sales of any petroleum product in any of the listed territories at the expense of any Shell company, then Shell shall have the right, by notice in writing to Gulf, to reduce in the following year the quantity for that year by an amount which shall not exceed (i) 70 percent of the crude oil equivalent (as hereinafter defined) of the quantity of such increase or (ii) the quantity of the oil attributable for that year, whichever is the smaller.[11]

In this paragraph, delivery period means the period running from 1947 to 1969 or thereafter until the contract is canceled. The "listed territories" are marketing territories listed in the agreement covering all of Europe and Asia not under Russian control, the islands of the Atlantic as far west as Iceland, the Canary and Cape Verde Islands, all of Africa, Australia and most of the islands of the Pacific.[12] "The crude oil equivalent" refers to an agreed upon method for converting Gulf's increased sales of refined products into an equivalent number of barrels of crude oil. "The quantity of oil attributable for that year" refers to the quantity of Kuwait oil which the parties assume, for purposes of the agreement, will be used by Shell in marketing in the marketing territories in question.

Under this provision, therefore, Gulf's sales of Kuwait oil to Shell would be restricted if its use of Kuwait oil in any marketing territory of the Eastern Hemisphere resulted in an increase in Gulf's business at the expense of Shell. The restriction would be a reduction in Gulf's sales to Shell equivalent to the smaller of either (a) 70 percent of the amount of Gulf's increase in sales or (b) the whole amount of Kuwait oil deliverable to Shell in the following year and allocable, under the contract to the marketing territory. These provisions, moreover, are so worded as to provide protection for all of Shell's business, whether based on Kuwait oil or on oil from other sources, in each of Shell's Eastern Hemisphere markets. Thus, Gulf was effectively proscribed

[11] Quoted as amended by the Supplemental Agreement between Gulf and Shell, dated February 14, 1950, the only change from the original text being to extend the application of this provision to the longer delivery period therein agreed upon, i. e., 1947 to 1969 or until cancellation of the agreement at a later date.

[12] The contract lists each Shell marketing subsidiary and joint marketing organization in the Eastern Hemisphere and lists the territories served by each. The contract states that these listings were made in order to provide an agreed basis for the price formula and that Shell is not, in fact, bound to market its Kuwait oil in accordance with the steps in the procedure for determining the price, but is free to market its Kuwait oil as it sees fit. Actually, the contract does not limit the use of the lists of marketing oragnizations and territories to the determination of price, but also uses the lists as a basis for reducing the quantity of oil which Shell would be required to take under the contract if Gulf should market Kuwait oil so as to reduce Shell's business in any of these "listed territories."

from using additional Kuwait oil so as to encroach upon any of Shell's markets in the Eastern Hemisphere.[13]

The expression, "proportion of the sales of any petroleum product" is nowhere defined in the agreement, nor is any method set up for determining that proportion or for determining whether any increase in that proportion is "at the expense of Shell." To give effect to this language, however, the following information regarding such petroleum product in each "listed territory", i. e., all markets in the Eastern Hemisphere, would have to be known for the year preceding the effective date of the contract, i. e., 1946, and for each succeeding year: (*a*) the total of Gulf's sales; (*b*) the total of Shell's sales; (*c*) the total sales of all marketers; (*d*) the proportion that Gulf's sales and Shell's sales, respectively, bear to the total sales of all marketers; and (*e*) the fact as to whether any increase in Gulf's proportion of business is made at the expense of Shell.[14]

The effect of this provision, therefore, is to discourage, and thus tend to prevent, any increases over Gulf's established position in any petroleum product in any market in the Eastern Hemisphere where such increases are at Shell's expense. This restriction was not in conflict with the provisions in the agreement of December 14, 1933, under which, with respect to the utilization of Kuwait oil, Gulf was obliged to confer with Anglo-Iranian to prevent encroachment on the latter's marketing position at any time or place. This is evidenced by the fact that the restrictions of the 1933 agreement were included by reference in the Gulf-Shell contract and by Gulf's statement that, while Gulf had advised Anglo-Iranian in 1946 of Gulf's sales to Shell, which began as soon as Kuwait Oil Co., Ltd., started producing commercially about the middle of 1946, Anglo-Iranian had made no objection to such early sales.[15] Furthermore, as will presently appear, the long-standing intimate relationships of Anglo-Iranian and Shell are such that the long-term commitments to Shell entered into by Gulf in 1947 effectively supersede and render unnecessary the earlier restrictions on Gulf of the 1933 agreement.

The above-mentioned restrictions are consistent with the principles and procedures governing "as is" relationships among cartel members under the international agreements described in chapter VIII of this report. Under the cartel agreements, restrictions on producing and marketing petroleum products were accepted not only by the principal "as is" partners, Shell, Anglo-Iranian, and Standard Oil Co. (New Jersey), but also by many other petroleum companies as well.[16] The general application of the "as is" principle in the Far East, for example, was made known by Sir John T. Cargill of Burmah Oil Co., Ltd., who stated, in 1934:

> We have agreements with our most powerful geographical and other competitors which respectively accept that principle in whole or in part.[17]

[13] The limitations on Gulf applied to all the "listed territories" enumerated in the contract, and any business done by Shell in the Eastern Hemisphere in markets not included in the comprehensive list would be a negligible part of Shell's Eastern Hemisphere operations.

[14] Clause 6, par. (6) (c) provides that, where this fact as to whether increases in Gulf's sales are at Shell's expense cannot be determined, then the above-mentioned penalties on Gulf do not apply.

[15] Gulf's application to the Securities and Exchange Commission, loc. cit.

[16] For details on these restrictions and their application, see chs. VIII and IX.

[17] The Petroleum Times, June 9, 1934, p. 622, quoting remarks by Sir John T. Cargill in reviewing the operations of Burmah Oil Co., Ltd. This statement was made at the time the Anglo-Persian, Shell, and Standard (New Jersey) companies were operating in European and Far Eastern markets under cartel agreements intended to implement the "as is" principle. Burmah Oil Co. has been previously mentioned on page 131 as a customer of Anglo-Persian and as a joint marketer in India with Shell. The 1933 restriction on Gulf applied to the relationships between Anglo-Persian and Burmah Oil. Burmah Oil was also a large stockholder in Anglo-Persian and Shell.

Gulf's entry into the Gulf-Shell contract of 1947 apparently was a solution to the problems raised by the beginning of large-scale commercial production in Kuwait in the middle of 1946. Gulf had to have an outlet for its oil, but was bound not to upset or injure Anglo-Persian's trade or market position at any time or place. This restriction on Gulf was a serious one, since Anglo-Iranian was an important marketer in many of the areas most accessible to Kuwait production. Finally, these accessible markets were strongly cartelized, and Gulf would have had heavy expenses in building the necessary facilities and in forcing its way into these markets against the opposition of the established companies. The way in which the Gulf-Shell contract solves these problems becomes apparent in considering Shell's circumstances at the time it entered into the contract and the terms as to price that have been discussed above.

As has been indicated, Shell was for many years a principal participant in the "as is" cartel arrangements, and thus was interested in preventing the entry of large amounts of uncontrolled oil into controlled markets. Shell's interest in the Gulf-Shell contract was dictated also by its long-standing intimate relationship with Anglo-Iranian, particularly in marketing arrangements, and by its unfavorable situation with regard to crude oil supplies for most Eastern Hemisphere markets.

Shell's and Anglo-Iranian's marketing interests reach into practically every market, large and small, in the Eastern Hemisphere.[18] While the two companies maintain separate organizations in many markets, they operate joint marketing organizations in many other markets.[19] This fact and the fact of long-term intimate cooperation of Shell and Anglo-Iranian, together with other companies, in the formulation and application of "as is" cartel principles tended to produce a solidarity of interests in the two companies.

However, Shell had not participated to the same extent as other companies in the joint development of the oil fields of the Middle East, which were advantageously located with reference to many markets of Europe, Africa, and Asia. Except for its interests in Iraq, Shell had

[18] Shell's marketing subsidiaries and the marketing organizations owned jointly by Shell and Anglo-Iranian are listed in the Gulf-Shell contract, pp. 132–139. These appear to include all Eastern Hemisphere markets outside of Russian-controlled territories except for such unimportant areas as Assam, Chittagong, and Borneo.

[19] Gulf-Shell contract, May 28, 1947, pp. 132–139. The companies indicated as joint marketing organizations and the markets listed as served by them are as follows:

	Company	*Markets served*
1.	Shell Mex. & B. P., Ltd	British Isles.
2.	The Shell Co. of Palestine, Ltd	Cyprus.
3.	The Shell Co. of Aden, Ltd	Aden, including Perim, Kamarin, and Kuria Muria Islands.
4.	The Shell Co. (Red Sea), Ltd	Eritrea, Somaliland (British, French, and Italian), Ethiopia, Hejaz, Asir, Yemen, Hadramaut, Soqotra, and Red Sea islands, except Egyptian territory.
5.	The Shell Co. of the Sudan, Ltd	Anglo-Egyptian Sudan.
6.	The Shell Co. of East Africa, Ltd	Kenya, Tanganyika, Uganda, Zanzibar, and the Seychelles Islands and their dependencies.
7.	Anglo-Iranian Oil Co. (East Africa), Ltd	
8.	The Shell Co. of Portuguese East Africa, Ltd	Portuguese East Africa (or Mozambique).
9.	The Shell Co. of Rhodesia, Ltd	Northern and Southern Rhodesia and Nyasaland.
10.	The Shell Co. of South Africa, Ltd	Union of South Africa, Bechuanaland, Basutoland, Swaziland, Madagascar, and Mauritius.
11.	Anglo-Iranian Oil Co. (South Africa), Ltd	
12.	The Shell Co. of South West Africa, Ltd	South West Africa and Walvis Bay.
13.	The Shell Co. of Ceylon, Ltd	Ceylon, Maldive Archipelago, and Chagos Islands.
14.	Burmah-Shell Oil Storage & Distributing Co. of India, Ltd.	India (including French and Portuguese India and the Laccadive, Andaman, and Nicobar Islands but excluding Assam and Chittagong), Afghanistan, Nepal, Bhutan.

played a small role, compared with other international oil companies, in the Middle East. In fact, its sources of production were, and still are, located mainly in the Western Hemisphere and the Far East, both areas being far away from Eastern Hemisphere markets important to Shell.[20] In contrast, Anglo-Iranian controlled the production of Iran, shared Iraq production with Shell and other international oil companies, and shared the production of Kuwait with Gulf.

It was into this structure of controlled production and marketing that both Anglo-Iranian's and Gulf's Kuwait oil was being fitted in 1947. The Gulf-Shell contract became the means of carrying over into the postwar period the observance of the cartel's prewar "as is" principle of preserving marketing positions.[21] Gulf, with a large volume of production newly developed at Kuwait, was hemmed in by the restrictions in its 1933 agreement with Anglo-Iranian and by the fact that the natural markets for that oil were strongly cartelized. Under the Gulf-Shell agreement, Gulf obtained an outlet for about out-quarter of its share of Kuwait's proven reserves, with deliveries spread over more than 20 years. Thus Gulf was able to dispose of this oil without competitively entering markets in which it did not already have a recognized marketing position. Anglo-Iranian recognized Gulf's need for a market and apparently regarded the sale to Shell as giving relief to Gulf while at the same time placing the control of the marketing of this important part of Gulf's share of Kuwait oil in strong hands where it would be marketed in such a manner as not to upset or injure existing market positions of either Anglo-Iranian or Shell. Thus, Shell at one stroke gained control of a potential disturbing element in its and Anglo-Iranian's markets and secured a substantial source of supply more advantageously located with respect to many of its markets than its owned sources of supply.

In summary, Gulf, at the time that Kuwait production began on a commercial scale in 1946, was restricted under the December 14, 1933, agreement with respect to any market in which Anglo-Iranian had distributing interests. Gulf, moreover, had neither an established marketing position nor a distribution organization and facilities in many Eastern Hemisphere markets. At the same time, Shell was operating with established positions vis-à-vis Anglo-Iranian under cartel agreements of long standing in markets throughout the Eastern

[20] Shell had some production in the Middle East and Europe, but its supply from these areas was inadequate to meet its needs in those markets. As late as 1949 and 1950, the sources from which Shell drew its total supply, including purchases from Gulf and others under long-term contracts, as reported in The Economist of June 9, 1951, p. 1380, were as follows:

Producing areas	1949		1950	
	Millions of barrels	Percent	Millions of barrels	Percent
Western Hemisphere	255.1	66.5	279.3	61.5
Far East	46.7	12.2	61.2	13.5
Middle East	18.6	4.8	22.6	5.0
Europe	3.2	.8	3.5	.7
Total produced by Shell	323.6	84.3	366.6	80.7
Purchased under long-term contract	60.1	15.7	87.7	19.3
Total produced and purchased	383.7	100.0	454.3	100.0

[21] Anglo-Iranian also similarly contracted in 1947 to sell part of its Kuwait production to Standard (New Jersey) and Socony-Vacuum, as described later in this chapter.

Hemisphere. In many such markets, Shell and Anglo-Iranian distributed through a single company under joint marketing arrangements.

By entering into a long-term marketing arrangement with Shell, Gulf found an outlet for at least 1¼ billion barrels of its share of Kuwait oil, with deliveries spread over a minimum period of 22 years, while Shell obtained crude oil which it needed to supply its established position in markets which it shared with Anglo-Iranian and others. Moreover, Gulf is restricted during this minimum 22-year period so that it can compete with Shell only to its own disadvantage. This arises because of the profit-sharing provisions of the 1947 contract and because of the limitations stated therein, which apply if Gulf should, by the use of Kuwait oil, encroach on Shell's business anywhere in the Eastern Hemisphere.

The new 1947 Gulf-Shell contract incorporated, by reference, the restrictions on Gulf of the 1933 Anglo-Iranian-Gulf agreement. Actually, the restrictions on Gulf in both agreements apply to much the same marketing areas. Insofar as Anglo-Iranian and Shell have joint marketing organizations in many of these territories, and market cooperatively in many others, the 1947 contract merely transfers to Shell the ultimate responsibility of controlling the distribution of Gulf's share of Kuwait production so as to protect the trading positions of both Shell and Anglo-Iranian.[22]

Thus, it appears probable that Gulf's opportunity to market additional oil out of Kuwait is limited quite largely, though possibly not exclusively, to those markets in which it already has an established marketing position accepted by the British-Dutch interests. Under these circumstances, the most important unrestricted markets of the world left open to Gulf for Kuwait oil appear to be those of the Western Hemisphere, and especially the United States.[23] Respecting such movement of oil, counsel for Gulf stated, in 1946:

> In the light of present transportation costs, it is likely that it would not be profitable to market Kuwait oil in the Western Hemisphere. However, the registrant [Gulf] believes, it is the opinion of the oil industry in general that in a few years it can be made profitable to bring the oil into the United States. * * * Thus, while admittedly the marketing provisions are restrictive and objectionable they probably will not have a material adverse effect upon the total enterprise represented by the registrant and its subsidiaries.[24]

Shortly after this statement was made, postwar price controls in the United States were removed in November 1946, whereupon the price of crude oil advanced at Gulf ports, with the result that Kuwait oil began to be imported into the United States in 1947.[25] Gulf Oil Corp. was among the importers. It imported at an average rate of 4,232 barrels daily in 1948, 29,745 barrels daily in 1949, and by the middle of 1950 at an estimated rate of 40,000 barrels daily. Two

[22] About 21 months after the Federal Trade Commission served a subpena on Gulf Oil Corp., requesting the documents upon which the above discussion is based, Gulf and Anglo-Iranian, in a document dated November 30, 1951, agreed to cancel the Anglo-Persian-Gulf agreement of December 14, 1933. Gulf Oil Corp. has voluntarily submitted a copy of the agreement of November 30, 1951, to the Federal Trade Commission. However, the cancellation of the 1933 agreement does not alter substantially the basic restrictions, discussed above, which hampered Gulf's marketing of Kuwait oil. Once Gulf was tied to Shell under the terms of the 1947 contract, the interests of Anglo-Iranian, as well as those of Shell, were protected, since the restrictive provisions of the 1947 agreement will operate in lieu of the restrictive provisions of the 1933 agreement.

[23] Anglo-Iranian does not market in the Western Hemisphere, and the Gulf-Shell contract does not apply to either Gulf's or Shell's business in the Western Hemisphere.

[24] Gulf's application filed with the Securities and Exchange Commission, loc. cit., pp. 9–10.

[25] Minerals Industry Report No. 308, p. 13; International Petroleum Trade, September 30, 1948, pp. 178–179.

other American companies, Socony-Vacuum Oil Co. and Atlantic Refining Co., also imported Kuwait oil in increasing quantities during this period.[26] In December 1950, Atlantic Refining Co. announced that it had entered into a contract with Gulf to buy approximately 12,000 barrels daily of Kuwait oil for a period of 5 years beginning in 1951.[27] This apparently about doubled Atlantic's daily average rate of purchases of Kuwait oil. Thus it appears that as soon as the price of crude oil in the United States advanced sufficiently to make it profitable to sell crude oil for importation into the United States, Gulf found outlets for Kuwait crude in the United States. Such sales were, of course, completely in accordance with its 1933 agreement not to use oil from that source to upset Anglo-Iranian's trade or marketing position directly or indirectly at any time or place.

ANGLO-IRANIAN AGREEMENTS WITH JERSEY STANDARD AND SOCONY-VACUUM FOR THE SALE OF CRUDE OIL

Soon after the Gulf-Shell sale of oil agreement was concluded, three other major international oil companies—Anglo-Iranian, Jersey Standard, and Socony-Vacuum—entered into similar long-term arrangements providing for the sale of Middle East oil owned by Anglo-Iranian to the two American companies. As in the case of the Gulf-Shell agreement, the sale of large quantities of oil over a long period of time, the unusual provisions with regard to price, the insertion of provisions governing the marketing of the oil, and the close relations otherwise existing between the three parties indicate that these agreements were not in the nature of an ordinary business transaction, but rather represented a mutual sharing of oil production on terms that harmoniously effected still another merging of interests in Middle East oil.

A large volume of oil was involved in the contracts. Jersey Standard agreed to purchase 800,000,000 barrels of crude oil over a 20-year period; and Socony, under two purchase contracts, agreed to take 500,000,000 barrels—or a rate of 110,000 barrels daily for Jersey Standard and 70,000 barrels daily for Socony. In 1949, Anglo-Iranian's average daily crude oil production in Iran and Kuwait, by

[26] Effects of Foreign Oil Imports on Independent Domestic Producers, a report of the Subcommittee on Oil Imports to the Select Committee on Small Business, House of Representatives, 81st Cong., 2d sess., pursuant to H. Res. 22, H. Rept. No. 2344, June 27, 1950, pp. 18–23. According to the subcommittee, the American companies known to be importing Kuwait crude oil, and the daily average quantities imported during the years 1948 and 1949, and the last half of 1950 were:

[Barrels]

Company	1948 [1]	1949 [1]	1950 [2]
Atlantic Refining Co.	1,235	1,211	6,665
Cities Service Co., Inc.	646	------	------
Gulf Oil Corp.	4,232	29,745	35,000–45,000
Socony-Vacuum Oil Co.	3,230	[3] 19,748	31,000
Standard Oil Co. (New Jersey)	12,400	11,968	------
Total	21,743	62,672	72,665–82,665

[1] Actual daily average imports for the year.
[2] Estimated daily average imports for the last 6 months.
[3] Kuwait and Iran oil combined.

[27] National Petroleum News, December 6, 1950, pp. 30–31.

way of comparison, was about 715,000 barrels daily.[28] It would seem evident, therefore, that for a long time to come, Jersey Standard and Socony would take a substantial proportion of Anglo-Iranian's production. The two American companies, in fact, acquired such a substantial interest in Anglo-Iranian's crude-oil production over a 20-year period, with special terms as to price and other matters, that they became, in effect, junior partners in Anglo-Iranian's crude-oil-producing enterprises in Iran and Kuwait. The creation of the joint enterprise, Middle East Pipelines, Ltd., was a logical way to solidify and to continue this merging of interests.

The stated purpose of the crude oil sales contracts was to provide "an assured and continuing market" for Anglo-Iranian's crude-oil production and to "provide for a part of the large oil requirements" of the "affiliated companies" of Jersey Standard and Socony. The decision of the three parties to build a Middle East pipeline to move their oil to the Mediterranean flowed from these twin purposes.

Anglo-Iranian was obviously interested in "an assured and continuing market" for its output, particularly in view of the increase in Middle East production as a whole. In the spring of 1947, Jersey Standard and Socony had reached a tentative agreement with Texas and Standard of California for their entry into Aramco and into Trans-Arabian Pipeline, and had signed the subscription agreements, off-take agreements, and other collateral papers. The negotiations with their IPC partners to permit the ultimate conclusion of these agreements and to settle other IPC matters had fairly well crystallized. At the same time the Gulf-Shell sale of oil agreement had been concluded and was in operation, and the building of new pipelines in Iraq was well advanced.[29] The effect of all these activities was to increase crude oil production in Saudi Arabia, Iraq, and Kuwait. With Middle East production thus on the rise, Anglo-Iranian would naturally wish to keep pace with the growth of Middle East production. To have fallen behind would not only have been undesirable from a purely commercial standpoint; it would also have weakened Anglo-Iranian's prestige in the Middle East.[30] Another factor in the bargain with American companies was the desire of Anglo-Iranian to build a pipeline from the vicinity of the Persian Gulf to the Mediterranean; American participation in this project would undoubtedly facilitate the procurement of both American steel and dollars which were necessary but scarce.

On their part, Jersey Standard and Socony gained under favorable terms a long-term, substantial supply of crude to meet their anticipated requirements in foreign markets. Moreover, this oil would benefit from cheap transportation via the projected MEPL pipeline. And perhaps of most importance, Anglo-Iranian, Jersey Standard, and Socony would all benefit in that the increases in Iranian production, indicated by the 1946–47 events in the Middle East oil industry, would be funneled into the hands of companies interested in maintaining world prices and markets.

[28] In 1949, Anglo-Iranian's total production in Iran and Kuwait, assuming that it took 50 percent of the production of the latter, was about 260,000,000 barrels, i. e., a daily average of 715,000 barrels. By the end of 1949, Anglo-Iranian's average daily production at these two sources had been stepped up to about 733,600 barrels. Included in Anglo-Iranian's 1949 production was an unknown volume of crude oil delivered to Socony under the interim agreement described below.

[29] The negotiations in each of these matters were conducted contemporaneously and by the same small group of men representing the companies involved.

[30] E. g., Anglo-Iranian's insistence on MEPL being incorporated in the United Kingdom rather than in the United States. See p. 154.

Thus the making of the long-term sale of crude oil agreements between Anglo-Iranian, Jersey Standard, and Socony added substantially to the interlacing and merging of oil interests that had developed in the Middle East over the course of 25 years. These developments tended to create common and identical interests among the major international oil companies in the Middle East through their joint and interlocking enterprises. The crude oil sales agreements, therefore, emerged as the last of the long series of events tending toward a unified oil industry in the Middle East.

Jersey Standard—Anglo-Iranian crude oil sales contract.—The agreements for the sale of crude oil and for the establishment of Middle East Pipelines, Ltd. originated in conversations apparently held sometime in August or September 1946 between Orville Harden, vice president of Standard Oil Company (New Jersey) and Sir William Fraser, chairman of the board of directors of Anglo-Iranian Oil Co., Ltd.[31] An unsigned memorandum, dated October 4, 1946, in Jersey Standard's files set forth the outlines of the preliminary agreement, in which the sale of oil and the pipeline are tied together in one package. The crude oil contract was to provide for the sale by Anglo-Iranian over a 20-year period of 160 million long tons (1,200,000,000 barrels) to Jersey Standard. Other features of the preliminary agreement, such as those relating to price, to Anglo-Iranian's option of supplying the oil either from its Iran or Kuwait sources, and to Jersey Standard's rights of termination of the contract at earlier dates were substantially the same as those in the final agreement. The two parties were to jointly finance and operate a pipeline of 300,000 barrels per day capacity, i. e., 15 million long tons annually, which was to run from the Persian Gulf to the Mediterranean.

Socony-Vacuum was brought into the agreement, apparently sometime in November,[32] being given 20 percent of Jersey Standard's crude oil purchase, (200 million barrels)[33] over a 20-year period, and a 10-percent interest in the pipeline, taken from Jersey Standard's share which was thus reduced to 40 percent. However, Socony's position was that of an adherent or lesser partner, and until late in the negotiations with Anglo-Iranian, Jersey acted on both its own and on Socony's behalf.[34]

Although the guiding principles were agreed upon at an early stage,[35] the ensuing negotiations proved long and tedious. In late August 1947, it became apparent that the pipeline agreement could not be concluded for some time, although the crude oil contracts were in

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[31] In a cable, dated October 15, 1946, to D. A. Shepard, Mr. Harden makes it clear that he and Sir William had personally agreed upon these projects. The time of the discussions is suggested by the memorandum discussed above. During the period August–December 1946, extensive discussions were being carried on by officials of Jersey Standard, Anglo-Iranian, Royal Dutch-Shell, and Socony-Vacuum about proposals for the dissolution of the red-line agreement, the development of a new IPC agreement, the entry of Jersey Standard and Socony into Aramco, and the building of the Trans-Arabia pipeline. At this time also an arrangement for sale of oil was already in effect between Gulf and Shell, although the agreement between them was not signed until May 28, 1947.

[32] The first mention of Socony in Jersey Standard's files appears in a memorandum dated December 3, 1946, and signed by O. Harden.

[33] Jersey Standard's purchase was previously reduced to 1 billion barrels according to a document Principles of Agreement, dated October 29, 1946.

[34] This is clear from numerous references in Jersey Standard's files. With regard to the Heads of Terms and supplemental letters, signed by the three parties on December 20, 1946, the following comment appears in a letter from B. R. Jackson (Anglo-Iranian) to O. Harden, dated December 17, 1946: "I suggest that they are in sufficiently final form, however, to be handed to Socony." Another example is given below, p. 148, footnote 43.

[35] The basic understandings between Jersey Standard and Anglo-Iranian were fully elaborated and set forth in a document known among the parties as the Heads of Terms. This document, which was initialed by the parties on December 20, 1946, stated the principles of agreement between the two parties that would govern the writing of the crude-oil contracts and the creation of the joint pipeline enterprise. Since the basis of Socony's participation in these projects was included in a letter supplementary to the Heads of Terms, a representative of that company also initialed that document and its two supplementary letters.

nearly final form.[36] Accordingly, on September 23, 1947, Anglo-Iranian signed contracts for the sale of crude oil with Jersey Standard and Socony, the terms of the two documents being identical in most respects. The following statement of the main provisions of the Jersey Standard-Anglo-Iranian contract, therefore, will serve also as a statement of the contents of the Socony-Anglo-Iranian first purchase contract.

Jersey Standard agreed to purchase 106,400,000 long tons[37]—about 800,000,000 barrels—of crude oil from Anglo-Iranian, the deliveries to commence with the completion of the pipeline to the Mediterranean and to continue over a 20-year period. The contract called for deliveries at the average rate of 90,000 barrels daily (nearly 33 million barrels annually) for the first 3 years, and at the average rate of 114,000 barrels daily (nearly 42,000,000 barrels annually) for the succeeding 7 years. The remaining part of the purchase, 410 million barrels, was to be delivered over a 10-year period, the annual quantities to be determined at a later time.[38] Jersey Standard could, at its option, cancel the contract at the end of its tenth or fifteenth year, a 5-year notice being required.[39] In the event that the then-current negotiations with Aramco failed, Anglo-Iranian agreed to negotiate with regard to the purchase of an increased volume of oil.[40]

The contract for sale of oil was contingent upon the making of the pipeline agreement[41] and was to go into effect only when the pipeline was completed, the target date being January 1952.[42] It was contemplated that the purchased oil would be delivered into the jointly owned and operated pipeline at which point ownership of the oil would pass from Anglo-Iranian to Jersey Standard. The latter company, however, was given the right to lift up to 5 percent of its annual takings by tanker in the Persian Gulf.[43]

[36] See letter, T. E. Monaghan (Jersey Standard) to Joseph Addison (Anglo-Iranian), dated August 27, 1947.

[37] Quantities are given in the contracts in long tons. Since the general practice in the United States is to state quantities in barrels, the barrel equivalents, as suggested by various correspondence in the files of Jersey Standard, will be given in this discussion in place of the figures in tons given in the contracts.

[38] Jersey Standard was to state by the end of the fifth year the quantities it desired to take during the eleventh through the fifteenth year, the total for the 5 years to be between 190 and 230 million barrels (25 to 30 million tons). A similar notice was to be given by the end of the tenth year specifying the quantities of the balance of the contract to be taken during the sixteenth through the twentieth year. Provisions were included to insure that there should not be a great variation in the quantities nominated by Jersey Standard during any two succeeding years. Daily average deliveries for the 10 years were to be about 114,000 barrels.

[39] No right of cancellation was given to Anglo-Iranian, because Jersey Standard required "definite assurance" of a "20-year commitment" on the part of Anglo-Iranian in order to justify its investment in the pipeline. (In other words, while Anglo-Iranian would continue to have use for the pipeline which would run from its concessions to the Mediterranean, Jersey Standard would require it only during the period in which it purchased oil.) Jersey Standard required a right of cancellation on its part, however, to guard against "unforeseen conditions." (Cable from O. Harden to D. A. Shepard, dated October 15, 1946.) Provisions were later put into the pipeline contract that, in effect, depreciated the investment in the first 10 years of pipeline operation.

[40] Sir William Fraser declined to put this offer in a formal letter, but agreed to make it verbally or in an informal letter. Letter from T. Monaghan to O. Harden, dated July 3, 1947. In a draft of a formal letter, attached to a letter from B. R. Jackson to O. Harden, dated December 9, 1946, it is provided that Jersey's purchase could be increased to 1.25 billion barrels (165 million tons) in the event negotiations with Aramco failed.

[41] It was provided that either party could terminate the contract if a pipeline agreement were not concluded by December 31, 1948, or a later date mutually agreed upon.

[42] Jersey Standard executive committee meetings, January 15, 1947.

[43] The 5-percent figure was arrived at after much debate by the two parties. Jersey Standard was anxious to insert a high figure to gain flexibility in the late years of the contract when it might want to make its annual takings considerably in excess of its share of pipeline capacity. In a "second draft" of the contract, probably drawn up in January 1947, it is provided that up to 25 percent of the purchased oil could be taken by tanker in the Persian Gulf. Anglo-Iranian, on the other hand, wanted to insure pipeline operations at the "highest possible point", i. e., at the most economic levels. Letter from L. C. Stevens to O. Harden, dated January 27, 1947. The issue was settled at the 5-percent level apparently without consultation with Socony, although an identical provision was in its contract. Socony's subordinate position in the negotiations is again shown in this regard by the following interoffice note from Orville Harden to S. P. Coleman, dated February 4, 1947. "Dear Stewart: Before we definitely agree with the Anglo-Iranian as to the percentage of oil that we have the right to take delivery of in any one year in the Persian Gulf, I think we owe it to Socony-Vacuum to confer with them. O. H."

Anglo-Iranian was given the option of making its deliveries either from Kuwait or Iran at its pleasure. This flexibility option was inserted to allow Anglo-Iranian to determine the source of supply as indicated by "political considerations".[44] Among the provisions to insure that the average quality of the oil delivered from either Iran or Kuwait was not less than the average quality of oil produced in either country, the following safeguard was included in the contract. Anglo-Iranian—

> shall keep currently during the supply period [20 years] * * * adequate records of the quality of oil produced in each field in Kuwait and * * * in Iran.[45]

These records were to be made available to Jersey Standard.

The price to be paid for this oil was determined by a cost-plus "principle" described in the contract as "a 'cost plus' basis independent of market fluctuations in the prices of crude oil or petroleum products."

The cost element of this formula included all costs of production and gathering per ton allocable to the oil delivered under the contract,[46] including the costs of delivering it into the eastern terminal of the Mediteranean pipeline or, in the case of the small quantities of oil to be lifted by tankship in the Persian Gulf, the costs of delivering the oil f. o. b. tankship.[47] The "plus" element of this formula consisted of a fixed money profit per ton, which was to apply throughout the 20-year supply period of the contract. This profit element paid to Anglo-Iranian was the factor that made the total price payable by Jersey Standard "independent of market fluctuations" since it stabilized that price for a 20-year period, subject only to changes in the actual costs of production and gathering of the oil.[48]

It would seem clear that extensive information would necessarily have to be made available to Jersey Standard so that it could determine whether the costs charged to it were properly determined. This is an essential characteristic of any cost-plus contract and distinguishes it from ordinary business transactions in which buyers and sellers "haggle" in arm's-length bargaining, independently of each other's conduct of their business affairs. Early in the negotiations for this contract, the principal negotiator of Jersey Standard referred to "our need for clearly knowing the definition of each cost factor and the proposed allocation of all items of expense, as well as having all documents and other factors that would affect the contract." [49] In a

[44] Cable from D. A. Shepard to O. Harden, dated January 23, 1947.

[45] Except for fields reserved for meeting domestic requirements in Iran.

[46] The provisions relating to price and to accounting records and procedures occupied 37 of the 81 pages of the contract. The accounting schedules in the contract set forth in detail the principles to be applied in determining and allocating each element of the costs incurred by Anglo-Iranian which would enter into the price per ton for the oil sold under the contract.

[47] The interests of Jersey Standard were safeguarded by the inclusion of various clauses in the contract which limited or shifted unusual or unfavorable cost burdens. The most interesting of these was a provision which stipulated that the royalty component in the costs to be paid by Jersey Standard on either Kuwait or Iran oil would never be higher than the concurrent royalty paid per ton, including payments for tax immunity, by IPC in Iraq or by NEDC as its share of the royalty per ton on any royalty oil deliverable to D'Arcy Exploration Co. (Anglo-Iranian). (This had reference to the Kirkuk field arrangements of IPC.) These provisions gave Jersey Standard a "guaranteed royalty ceiling." Memorandum from E. L. Estabrook to L. F. McCollum, dated January 24, 1947 (files SONJ, part 14–B.)

[48] Jersey Standard's interests were further safeguarded by a "most favored nation" clause which stipulated that the total price paid by Jersey Standard would in no case exceed the price charged by Anglo-Iranian or Kuwait Oil Co., Ltd., to any other long-term purchaser of Iran or Kuwait oil. Spot sale and short-term contract prices were excluded from this guaranty. Kuwait Oil Co. was included to guard against the possibility of sales by it being used as a subterfuge by Anglo-Iranian to escape this clause in the contract. Letter from L. C. Stevens to O. Harden dated January 27, 1947. If a lower "differential," i. e., fixed payment per ton over costs, were granted any other customer, then Jersey Standard would receive the benefit of such "differential." If the prices to another customer, as determined by any other "principle" than cost plus, were, in sum, lower than the price to Jersey Standard, its price was automatically lowered accordingly.

[49] Letter from O. Harden to B. R. Jackson (Anglo-Iranian), dated November 7, 1946.

letter supplemental to the "Heads of Terms," dated December 20, 1946, initialed by officers of Jersey Standard, Socony, and Anglo-Iranian, the following appears:

> 3. We feel obliged to ask that Jersey be permitted from time to time to audit so much of the books of Kuwait Oil Co., Ltd.,[50] as may be necessary to verify accounting statements relevant to the crude-oil contract.
>
> We would prefer that this be done by Jersey employees, but if this is unsatisfactory to AIOC, we would probably be willing to agree that such audits would be made by independent accounting firms—such as Price, Waterhouse & Co.—retained and paid for by Jersey.

The issue was not settled this easily, however. Although the parties soon came to an agreement upon the accounting principles to be applied and the allocation of the elements of cost among capital and current charges,[51] the question of who would make audits remained in dispute. Jersey Standard officials were unyielding in their stand that the accounts be audited by their own or by independent auditors retained by them, insisting that such a review of the accounting books was necessary to fulfill their definite responsibilities to their stockholders.[52] Anglo-Iranian countered by stating that "we are not in a position to give them access to the Kuwait Co.'s books without previous reference (to) Kuwait partners." It proposed, "in conformity with usual practice on this side," that a "certificate given by Kuwait Co.'s auditor * * * would be satisfactory safeguard by both parties." [53] It insisted that the procedure proposed by Jersey Standard "might reflect on (the) reputation and professional status of auditors and involve ethics questions as between (Kuwait's) auditors and (Jersey Standard's) independent auditors." [54]

Under the final compromise on this issue, as stated in the contract, the annual audit of the books and records of the Kuwait Oil Co. was to be made by the statutory auditors of that company, who were to be specially retained and paid for this work as "independent auditors" by Jersey Standard and Anglo-Iranian. The statutory auditors of Anglo-Iranian were to be similarly specially retained by the two parties to examine the relevant books and records of the Anglo-Iranian and render a certificate to the auditors of Kuwait.

It was further provided that Jersey Standard would be "entitled to receive" from Anglo-Iranian "any and all information which buyer (Jersey Standard) may reasonably request, from time to time, as to any of the matters enumerated" in the preceding parts of the article in the contract, namely, the books and records relating to all the elements of cost which entered into the price to be paid by Jersey Standard. The disclosure of such information would result, in effect,

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[50] Kuwait Oil Co. was specified because the parties had agreed that the cost of production per ton of Kuwait oil should apply to all oil delivered under the contract regardless of whether it was produced in Kuwait or in Iran, although the costs of royalties, gathering, and so on were to be separately determined and applied for Kuwait and Iran oil. This use of Kuwait costs was feasible because the differences in the costs of production in Iran and Kuwait were, according to Sir William Fraser, "unknown but probably small." Cable from D. A. Shepard to O. Harden, December 4, 1946. A preliminary review of "very approximate data" supplied by Anglo-Iranian indicated that producing costs in Kuwait, including gathering costs, would be about 27 cents per barrel for the purchased crude. This estimate was based on estimated reserves of 4 billion barrels and production of 300,000 barrels per day. All estimates, however, were tentative, since commercial production in Kuwait had been started only in July 1946. Cable from L. C. Stevens to J. C. Anderson, November 20, 1946.

[51] Such agreement was reported in a letter from L. C. Stevens to J. C. Anderson, November 20, 1946. A draft of the accounting schedules to the contract substantially in the form finally adopted was prepared and signed on December 13, 1946.

[52] Memorandum of a telephone conversation on February 21, 1947, between L. C. Stevens and T. Monaghan. Socony concurred with Jersey Standard in its demands for an independent audit. Cable from G. V. Holton to W. L. King, Jr., dated March 3, 1947.

[53] Cable from the chairman (Sir William Fraser) to B. R. Jackson, dated January 2, 1947.

[54] Cable from T. Monaghan to L. C. Stevens, dated February 24, 1947.

in opening up to Jersey Standard nearly all the details of the operations of Kuwait Oil Co., Ltd., and many details about Anglo-Iranian's business in Iran.[55]

The crude-oil sales contract, therefore, implied a long-term close association between Jersey Standard and Anglo-Iranian. This conclusion is supported by the details given above on the quantities of oil to be supplied, the length of the supply period, the nature of the pricing principle (cost plus), the stipulations regarding the disclosure of information as to quality and as to costs, etc. Underscoring the fact of this contemplated long-term association was the joint participation of the parties in the financing and construction of the Mediterranean pipeline.

An understanding between the two parties defining the ultimate market for which this oil was destined further emphasizes their close association. The contract for the sale of oil included the following provision:

> Nothing in this agreement shall limit or restrict buyer (Jersey Standard) as to the sources from which it supplies any area or as to the areas to which it delivers supplies from any source. It is, however, buyer's intention in entering into this agreement to use oil receivable by buyer hereunder in *supplying buyer's business in Europe* (*including the British Isles*), *North Africa* (*including the whole of Egypt*), *and West Africa*, all of which areas are hereafter referred to as "the reference area". [Italics added.]

The meaning of this provision, i. e., limiting the areas within which the purchased oil is to be ultimately distributed, becomes clear on reviewing the discussions of the parties in its preparation. Early in the negotiations, a Jersey Standard official stated:

> I told Basil (B. R. Jackson of Anglo-Iranian) that so far as crude oil deliverable by pipeline was concerned, it was for the purpose of helping to supply the requirements of our total business in the European and North African countries along with IPC, Saudi Arabian, Venezuelan, and * * * other crudes.[56]

The first draft of the contract which included a definition of "the reference area" read as follows:[57]

> Europe (including the British Isles), Africa, Asia Minor, and India.

This proved to be unacceptable to Anglo-Iranian which objected to the specification of "particular countries", and was "unwilling to include areas east of Suez." [58] The wording that was finally settled on was substantially that proposed by Anglo-Iranian except for the specific mention of the British Isles and Egypt.[59]

The restrictive nature of the above-quoted provision of the crude-oil contract is further revealed by the context in which it was placed. This provision introduced the "Force Majeure" article which provides for adjustment of the contract in the event of unforeseen events such as acts of God and of governments, insurrections, and the like. The intentions of Jersey Standard in negotiating the lengthy and complicated clauses in this article were succinctly stated by a Jersey Standard

[55] This conclusion is put in these words, because, while the Kuwait costs of production, gathering, royalties, and so on were all applicable to the price formula, the applicable elements of cost for Iranian oil included only the costs of royalties and gathering; see p. 150, footnote 50.

[56] Letter from Orville Harden to D. A. Shepard, December 16, 1946. No mention was made in the letter about the oil to be lifted by tanker in the Persian Gulf. It may be presumed that this small part of the total purchase was destined for distribution in the Far East by Jersey Standard's affiliate, Standard-Vacuum.

[57] "Second draft" of the crude-oil contract, undated.

[58] Cable from T. Monaghan to E. Johnson, March 4, 1947. This sensitiveness to the inclusion of areas east of Suez reappeared in the supplementary agreement of April 5, 1949; see below, p. 157.

[59] These were included because Jersey Standard thought it was necessary that they go in. Memorandum attached to letter from T. Monaghan to J. Addison (Anglo-Iranian), April 30, 1947.

official:[60] "I said that in the event of a market being lost to us, say because of its being nationalized, I thought the fairest plan would be to reduce the takings under the contract in proportion to what our total business in such market represented to our total business in the remaining countries of Europe and North Africa." This intention appears to have been carried out in the "Force Majeure" provisions of the contract, for the effect of these provisions is that in the event of the loss of part or all of any markets, the oil purchased by Jersey Standard was not to be diverted to any market outside the "reference area," but rather the amount of oil deliverable under the contract would be reduced.

Socony-Anglo-Iranian first purchase agreement.—The Socony-Vacuum Oil Co., Inc., signed a sale of oil agreement, dated September 25, 1947,[61] substantially the same as that signed on the same day by Jersey Standard and Anglo-Iranian. This agreement, known among the parties as the first purchase agreement, differed from the one previously described only in the definition of the "reference area."

The total quantity of oil to be purchased by Socony over the 20-year period was 26,600,000 long tons (200,000,000 barrels). During the first 10 years of the contract, Socony was to take delivery of 10,000,000 barrels annually (28,000 barrels daily). The balance of the oil (10,000,000 barrels) was to be taken during the last 10 years in quantities to be specified by the same procedure as that provided in the contract between Jersey Standard and Anglo-Iranian.[62]

Socony's "reference area" differed from that of Jersey Standard only by the inclusion of "the countries bordering on the eastern Mediterranean (including any islands within or adjacent to this area)."

Socony-Anglo-Iranian second purchase agreement.—Sometime during the summer of 1947,[63] Socony and Anglo-Iranian agreed that a second agreement for the sale of oil would be arranged between them under substantially the same terms as the contracts that were then in the final stages of negotiation. Accordingly, on March 1, 1948, the two companies entered into an agreement, known as the second purchase agreement, whereby Anglo-Iranian agreed to sell to Socony over a 20-year period 40,000,000 long tons (300,000,000 barrels) of crude oil. Over the first 10 years of the contract, Socony was to accept deliveries into the pipeline[64] at the rate of 15,000,000 barrels annually, i. e., at the rate of 42,000 barrels daily. The balance of the oil (150,000,000 barrels) was to be delivered during the last 10 years of the contract in annual quantities nominated by Socony.[65] This contract was to go into effect and delivery of the oil to commence, as in the previous

[60] Letter from Orville Harden to D. A. Shepard, December 16, 1946.

[61] This is the date given on the contract. Actually, however, the definition of the "reference area" appears to have been agreed on and the contract signed at a somewhat later date. Letter from C. L. Harding to B. R. Jackson, October 15, 1947.

[62] See p. 148, footnote 38.

[63] On September 5, 1947, Socony made a formal request that capacity be reserved for it in Middle East Pipelines, Ltd., to move the additional oil it expected to acquire under this second contract. Memorandum from T. E. Monaghan to B. B. Howard, September 6, 1947.

[64] However, Socony could elect to take 5 percent of the annual quantities at Persian Gulf ports, a provision included in all three sale-of-oil contracts.

[65] As in the Jersey Standard contract, the quantities nominated for any two successive years could not vary greatly. Socony could terminate the contract, after giving a 5-year notice, at the end of the tenth or fifteenth year.

contracts, with the beginning of operations of the Mediterranean pipeline.[66]

With regard to the markets for the crude oil purchased under this second contract, the intention of Socony and Anglo-Iranian was to direct the oil principally to the United States. The following appears in the contract:

> It is, however, buyer's (Socony's) intention in entering the agreement that the oil receivable hereunder should be utilized to supplement buyer's available supplies for importation into the United States.

This oil was not to enter the reference area stated in the first purchase contract, since the force majeure article in which the above sentence appears, was designed "to keep United States separate from [the] other reference area."[67] Nevertheless, the contract appears to give Socony some latitude in disposing of the oil, since the above language would permit, and other provisions of the contract make provision for, the export of products refined from this oil to foreign markets.[68]

The second purchase agreement thus incorporates the same general principles as those in the Jersey Standard and first purchase agreements, differing from the two earlier agreements only in minor details. Thus the oil in all three cases is to be supplied at the option of Anglo-Iranian from its Kuwait or Iranian fields, and is to be directed to specified markets. The contracts are all contingent upon the building of the Mediterranean pipeline and are to be in effect for 20 years. All three contracts provide for cost-plus pricing principles. In each contract substantially identical provisions are inserted relating to cost accounting, auditing, and the obligation of Anglo-Iranian to supply "any and all information" which Socony or Standard might "reasonably" request relating to these matters. In short, except for

[66] The price to be paid for this oil was determined by a cost-plus principle that varied somewhat from the formula in the earlier contracts in that it incorporated a profit-sharing element. The "cost" element in this formula was the cost per ton determined in accordance with the procedure set forth in the Jersey Standard contract. The "plus" or "differential" element in the formula was one-third of the difference between the total average cost per ton of the oil delivered f. o. b. tankship at the Mediterranean terminal of the pipeline and the "average open market value" per ton of oil at that point. Since this "value" corresponded to the world market price as applied in eastern Mediterranean ports, this was, in effect, a plan for sharing the profits on the crude oil—one-third of the profit per ton, i. e., the differential, being payable by Socony to Anglo-Iranian, and two-thirds of the profit being retained by Socony.

Although Anglo-Iranian got only one-third of the profit per ton, it is probable that this formula gave Anglo-Iranian a better return than under the two earlier contracts. This is suggested by the statement of Anglo-Iranian that "they have no present contracts other than Jersey and Socony which are more favorable and have no present intention of making more favorable contracts." (For this reason, Anglo-Iranian refused to grant Socony a "most-favored-nation clause", i. e., an agreement such as that in the Jersey contract guaranteeing to extend to Socony lower prices granted to any other buyer and also because such a clause "does not apply to profit-sharing arrangements".) Cable from Harding to Sheets, October 7, 1947. The "differential," however, was free to fluctuate only within maximum and minimum figures which were stated in the contract. The minimum figure put a floor under Anglo-Iranian's profit per ton and the maximum figure put a ceiling on the amount that Socony would have to pay to Anglo-Iranian per ton as profit. Thus the total price per ton paid by Socony under this contract was more subject to variation than the prices under the two earlier contracts, since both elements of the cost-plus formula were subject to fluctuation.

[67] Cable from Harding to Sheets, October 7, 1947.

[68] It is not clear just how broad this latitude was intended to be. The force majeure article of the contract indicates that products refined from this oil might be sold in foreign markets and even that some crude oi might be refined in foreign areas, the latter being regarded as improbable, however. It is provided that, in the event force majeure makes it impractical to import the oil into the United States, the quantities taken annually during the period such force is in operation will be reduced "appropriately." However, in the event force majeure makes it impractical to deliver the products refined from the oil in a foreign market, the oil is to be utilized in the United States. The possibility of the oil or its products being utilized in foreign markets is also provided for in the terms of payment, the oil to be paid for in dollars when delivered to the United States, to countries having currency freely convertible into dollars, or to countries which will allot dollars for the purchase of the oil, and to be paid for in sterling in all other cases. The parties primarily intended that this oil be paid for in dollars, unlike the oil deliverable under the first purchase agreement which was to be paid for in sterling, and agreed that oil delivered under the first purchase agreement and sold in any such "dollar" areas would be substituted for any oil delivered under the second purchase agreement and sold in "sterling" areas. Letter from C. L. Harding to B. R. Jackson, October 17, 1947. Taking all these provisions into consideration, the primary intention of the parties seemed to be to restrict the market for oil deliverable under the second purchase agreement to the United States and possibly other "dollar" marketing areas. The marketing areas are not so specifically delimited, however, as in the Jersey Standard and first purchase contracts.

some differences in details or in wording, the three agreements are substantially the same.[69]

Middle East Pipelines, Ltd.—In the first discussions between Jersey Standard and Anglo-Iranian regarding a long-term contract for the sale of crude oil, it was agreed that this contract would be contingent upon the "commissioning" of a jointly owned pipeline from the vicinity of the Persian Gulf to the Mediterranean. This pipeline project, therefore, was conceived of as an integral part of the total bargain between the parties. Accordingly, the three parties—Anglo-Iranian, Jersey Standard, and Socony—negotiated a pipeline agreement, signed on March 23, 1948, which set forth their detailed agreements on the size, financing, and operation of the proposed pipeline. Although construction of the pipeline has been repeatedly delayed and is now postponed for several years at least,[70] a review of the provisions of this agreement throws additional light on the close association of the interests of the three parties that was contemplated under the contracts for the sale of oil.

The three parties created a joint enterprise, Middle East Pipelines, Ltd. (MEPL), to finance, construct, and operate the pipeline, the shares of ownership being: Anglo-Iranian, 60.9 percent; Jersey Standard, 24.7 percent; and Socony, 14.4 percent.[71] It was agreed that "none of the shares in the capital of the pipeline company" held by the three shareholding companies could be "sold, transferred, hypothecated, or otherwise disposed of," except to a subsidiary or to a successor company, during the life of the agreement. However, should any of the crude-oil supply contracts be terminated,[72] Anglo-Iranian was given the right to acquire the shares of the company terminating a contract by paying in sterling "the fair value" of the shares or a price equal to that of any bona fide offer of a third party.

The capacity of the proposed pipeline was fixed at 535,000 barrels daily, each of the owning parties to have the right to utilize the line, for its own requirements or on behalf of others, in the proportion represented by their share ownership in MEPL. This meant that there was no surplus capacity available to Jersey Standard and Socony.[73]

The capacity available to Anglo-Iranian—326,000 barrels daily—was considerably in excess of its projected requirements, which Anglo-Iranian had estimated would average 210,000 barrels daily in 1952

[69] Socony entered into two other agreements with Anglo-Iranian in the spring of 1948. One of these agreements was of a short-term nature, providing for the purchase from Anglo-Iranian by Socony of 6,500 barrels of crude oil daily from June 15, 1948, to the end of the year. The other agreement, described variously as "interim purchase agreement" and the "interim crude supply contract," became effective on January 1, 1949, and is to "expire on the day that contract No. 2 [the second purchase agreement] becomes operative." The quantity of oil to be purchased and the terms and conditions of sale under this 3-year agreement are not known to the Commission.

Socony's imports from the Kuwait-Iran area into the United States in 1949–50 were apparently made under this contract. (Effects of Foreign Oil Imports on Independent Domestic Producers, hearings before the Select Committee on Small Business, House of Representatives, 81st Cong., 1st sess., pursuant to H. Res. 22, pt. II, 1949, p. 504.) These imports totaled about 7,440,000 barrels in 1949, and were estimated at 10,780,000 barrels in 1950. (Effects of Foreign Oil Imports on Independent Domestic Producers, a report, op. cit., p. 21.) Jersey Standard also imported oil from the Kuwait-Iran area in 1948 and the first 7 months of 1949, but it is not known under what arrangements the oil was purchased. Its imports in 1948 were about 7,300,000 barrels, and in 1949 about 5,250,000 barrels.

[70] See pp. 158–160.

[71] A two-thirds vote of the directors of shareholders was required to pass any resolution, i. e., Anglo-Iranian could not carry any resolution without the support of one of the American companies, but had a veto in that no action could be carried without its approval.

[72] See p. 148.

[73] This followed from the fact that their share of the capacity of the line was roughly equivalent to the daily volumes of oil, that they were committed to take under the crude oil supply contracts, plus allowances for a 10-percent variation above average requirements and for contingencies. The pipeline capacity allotted to and the contract requirements for Jersey Standard were in each case 132,000 barrels daily, and for Socony, 77,000 barrels daily.

(the expected first year of operation of the pipeline), 250,000 barrels daily in 1960, and 275,000 barrels daily in 1965.[74] While not stated in the agreement, it is apparent that Anglo-Iranian's excess capacity was to be allotted to Gulf Oil Corp. and to Royal Dutch-Shell, presumably to move Kuwait oil. It was anticipated that Anglo-Iranian would come to a separate agreement with Gulf and Shell with regard to the amount of capacity that would be allotted to them, their share in financing Anglo-Iranian's share of the pipeline, and so on.[75] Thus, although the pipeline agreement provides for only three shareholders in the pipeline company, it was anticipated that five international oil companies, controlling a large share of Middle East oil, would share in the utilization of the capacity of the pipeline.

It was agreed that the pipeline project would be financed by the three oil companies in proportion to their stock ownership, each party providing its due share of the dollars and sterling that would be required.[76] To solve the problem of the companies in providing the currencies required, reciprocal loan agreements were signed together with the pipeline agreement, whereby the American companies agreed to lend dollars to Anglo-Iranian to supply part of their anticipated needs, and Anglo-Iranian agreed to lend equivalent amounts in sterling to the American companies. These loans were to be called by the parties and re-lent to MEPL to meet MEPL's money requirements from time to time. The loans were to be repaid during the 10 years following the commissioning of the pipeline or January 1, 1955, whichever was earlier. On its part, MEPL was to repay its loans from the parent companies "as soon as practicable" and in any event within 15 years from the date on which crude oil would be first delivered through the pipeline. The loans were further safeguarded by a provision that, as permitted by English income-tax laws, the "initial allowances", i. e., all capital costs incurred before the date of commissioning of the pipeline, would be "depreciated" or amortized over the first 10 years of operation.[77]

The recitation of the provisions of this or of the related crude oil supply contracts, however, does not reveal the breadth and generality of the considerations that influenced the negotiations and shaped the final agreements. For example, one of the many issues that was discussed at considerable length was that of the "nationality" of the pipeline company.[78]

The importance of the pipeline project arises from the fact that it was conceived of as an integral part of the agreements for the sale of crude oil. The relations between the participating companies in all these agreements were well typified by the comment of an official of

[74] Memorandum from C. L. Lockett to H. W. Page, May 6, 1947.

[75] The question of the amount of capacity to be offered to Gulf and Shell and their participation in the financing of the pipeline occurred frequently in the negotiations as to the size of the pipeline, Anglo-Iranian appearing as an advocate of a large capacity line. The final solution of this problem, as above stated, was proposed by the American companies and was reluctantly accepted by Anglo-Iranian. Cable from Monaghan to Howard, October 15, 1947. It was anticipated that Anglo-Iranian's arrangement with "outside shippers," i. e., Gulf and Shell, for disposition of their unused space "would probably be a reasonably long-term one."

[76] The stated money requirements, including construction costs and working capital, were £25,000,000 plus $100,000,000, i. e., the equivalent of $200,000,000. Soon after the agreement was concluded, MEPL officers prepared a "project budget," i. e., a budget for construction of the line, dated April 20, 1948, estimating the cost at $232,000,000. MEPL Management Report No. 11, October 4, 1948, p. 2.

[77] Schedule to the pipe line agreement. This also protected the American companies in the event they elected to terminate the crude oil contracts at the end of the tenth or fifteenth year of the supply period; see p. 148.

[78] This was an important issue because it affected the tax liabilities of the owners of the company, important features of the control and operation of the pipeline, currency and procurement matters, and the problems of financing and disposing of the revenues of the company.

one of the companies made in the course of debate during the negotiations:

> I underlined to the Anglo-Iranian gentlemen that we were not endeavoring to make a "trade" in the generally accepted sense of the word, but were trying to find a basis on which partners could cooperate.[79]

Supplementary agreements.—It had been originally anticipated that the pipeline project would be completed by the end of 1951 so that the first full year of operation of the pipeline and of the contracts for the sale of oil would be 1952.[80] Due to the slowness of negotiations for wayleave conventions with Syria and Iraq, across which the pipeline was to be built, and to expected delays in obtaining steel pipe, it soon became apparent that this target date could not be met.[81] Accordingly, supplementary agreements to the three contracts for the sale of oil and to the pipeline agreement were negotiated by the three parties and were signed on April 5, 1949. These supplementary agreements readjusted the rights and obligations of the three oil companies so that, the appropriate safeguards to their respective interests being made, the crude oil contracts would become effective as of January 1, 1952, the purchased oil being lifted by Jersey Standard and Socony by tanker at Persian Gulf ports. The pipeline project in the supplementary agreements was reduced from a settled matter to a tentative one, and due to the continued operation of the abovementioned delaying factors, it was decided, in 1950, to postpone the project for at least 3 years.[82]

On the same day that the pipeline agreement was signed, March 23, 1948, an "agreement in principle with details to be worked out later" was reached between Jersey Standard and Anglo-Iranian which would permit Jersey Standard "to take crude by tanker in lieu of pipeline, such deliveries to be applied against crude contract and to begin July 1, 1951, and to continue until pipeline is completed and in operation." [83] This preliminary understanding was developed into a formal proposal by Jersey Standard, dated August 30, 1948, that was accepted as the basis of negotiations by Anglo-Iranian.[84] The principles of agreement set forth in this letter were substantially incorporated in the elaborate and complicated documents that were written to preserve the rights and obligations of the parties that had been agreed upon in the earlier agreements. It was agreed that, even though the Mediterranean pipeline were not constructed by that time, the "supply period"—the 20-year period during which the crude oil contracts were to be in effect—would begin on January 1, 1952. The crude oil was to be delivered into tankships in the annual quantities agreed upon in the basic contracts at Mashur, Iran, and was to be of the average quality of the total gross production in Iran.[85] These tankship deliveries were to be suspended when the Mediterranean

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[79] Letter from R. H. Porters to Leo D. Welch, February 18, 1948.

[80] MEPL, Management Rept. No. 7, June 3, 1948, p. 6.

[81] Idem. The slowness of negotiations for wayleaves up to the spring of 1948 was due in part to the fact that no direct approach to the Syrian or Iraq Governments could be made until after the incorporation and registration of MEPL were completed and power of attorney could be given the negotiators. MEPL, Management Rept. No. 1, December 3, 1947.

[82] See below, p. 158.

[83] Cable from Orville Harden to Abrafran (F. W. Abrams), March 23, 1948.

[84] While Socony apparently did not submit a companion letter to this, its files show that it participated in its preparation and in the negotiations that were had on the basis of this letter.

[85] In the event that oil of such quality could not be delivered at Mashur, it could be lifted at Abadan. It was anticipated that the oil delivered at Mashur would be produced at the Agha Jahri field in Iran. This oil was of average Iranian quality and was produced in sufficient quantities to meet contract requirements. Cable from Coleman to D. A. Shepard, November 10, 1948. Production at the Agha Jahri field was nearly 67 million barrels in 1948 and more than 84 million barrels in 1949 (World Oil, July 15, 1950, p. 203).

pipeline was completed, and the provisions of the basic contracts would then come into effect.

The price to be paid for this oil was to be determined in accordance with the procedure described in the basic contracts, that is, it included all the costs of producing and gathering the oil, including the costs of delivering it f. o. b. tankship at Persian Gulf ports, i. e., Mashur.[86] With regard to this last price element, a new formula for its determination was agreed upon for the oil purchased under Socony's second purchase agreement which preserved the principal that the "differential" should consist of one-third of the gross profit per ton, i. e., the difference between total costs and world market prices.[87] The provisions of the basic contracts relating to accounting, auditing, the furnishing of information about costs, and so on, were to apply under the supplemental agreements without change.

One of the features of the basic contracts was the definition of "reference areas," i. e., markets in which it was the stated intentions of Jersey Standard and Socony to sell the oil delivered through the pipeline. The contracts provided, however, that 5 percent of the annual quantities purchased could be lifted by tanker in the Persian Gulf; that provision presumably permitted the delivery of 5 percent of the oil in far-eastern markets. The intention of the parties in preparing the supplementary agreements was to preserve these marketing arrangements,[88] and to this end the following provision was included in each supplementary agreement to the crude-oil contracts:

> If in any year of the supply period during which f. o. b. tankship deliveries are made * * * more than 5 percent of the quantity deliverable in the year in question pursuant to the supply agreement is shipped by buyer [i. e., Jersey Standard or Socony] to destinations east of Suez, then the price for each such cargo of such excess quantity shall be seller's [Anglo-Iranian's] established spot cargo price f. o. b. tankship for shipment to destinations east of Suez in effect at the Persian Gulf port at which the particular delivery was made at the time such delivery was made.[89]

The effect of this provision is to penalize all oil, in excess of 5 percent of the quantities acquired annually under the contracts, which is shipped to destinations in the Middle East (except Turkey), all of Africa (except West Africa), India, and the Far East, and Australia and Oceania, and to direct up to 95 percent of the oil to the areas which Jersey Standard and Socony would "normally have supplied with such oil after transportation through the pipeline, were the pipeline completed." [90]

[86] The Iranian royalty, however, in accordance with the terms of the basic contracts, could apply only to 50 percent of the oil purchased annually, the Kuwait royalty applying to all Iranian oil in excess of 50 percent. This provision had originally been inserted in the contracts to protect Jersey Standard and Socony against the contingency that the higher Iranian royalty would apply on more than 50 percent of their annual purchases. The provision that the royalties would not exceed, in any event, that paid by IPC also applied under this contract.

[87] The elements of this formula were necessarily rather arbitrary. The value element in the formula—"the average open market value of oil f. o. b. tank ship Mediterranean terminal" was to be determined in accordance with the procedure prescribed in the second purchase agreement except that the "Mediterranean terminal" would be "assessed as for export delivery f. o. b. tankship Haifa, or Tripoli, or other representative oil-export terminal." The cost element of the formula was to consist of the costs per ton of production, gathering and loading, and royalties, plus the difference between the cost per ton in sterling of transporting oil by tanker from Mashur to the United Kingdom and the corresponding cost per ton between Haifa to the United Kingdom. A "tanker freight differential" schedule was appended to the supplementary agreement showing how this last cost factor was to be determined. The difference between the "value" and the "cost" of the oil represented the "gross profit." One-third of this sum was the "differential" which was to be paid to Anglo-Iranian, while two-thirds was retained by Socony. Maximum and minimum limits to the amount of this differential were included in the supplementary agreement.

[88] Letter from Jersey Standard to Anglo-Iranian, August 30, 1948.

[89] "Destinations east of Suez" was defined as meaning "destinations in the Eastern Hemisphere either (i) east of longitude 60° east or (ii) both east of longitude 15° east and south of latitude 30° 30′ north."

[90] Letter from Jersey Standard to Anglo-Iranian, August 30, 1948. The restrictive effect of this provision might be cited as evidence supplementary to that given in ch. V, with regard to the Bahrein Petroleum Co.'s marketing problems prior to 1948, suggesting that marketing cartels were in operation in these areas east of Suez.

The other provisions in the agreements supplementary to the three contracts for the sale of crude oil and the pipeline agreement were designed to provide a procedure for settling the future of the pipeline project and to safeguard and preserve the rights and interests of the parties under all contingencies. These provisions were summarized by Orville Harden as follows:

(2) The pipeline situation will be reviewed in 1956 and in 1961 and at either of these times the pipeline agreement may be terminated if construction is not substantially started. In the event of such termination the crude oil contract will terminate 5 years later.

(3) If the crude oil contract is not thus terminated, but Jersey terminates it at the end of the tenth or fifteenth year and Anglo-Iranian does not purchase Jersey's pipeline shares, Jersey may continue the crude supply contract under contract terms up to a date fixed by it or until the end of the tenth year after completion of the line, whichever is earlier.

(4) If the pipeline has not been substantially started by 1966, the pipeline agreement terminates.[91]

This summary equally applies to the Socony-Anglo-Iranian supplementary agreements as well. None of the supplementary agreements were intended, however, to affect in any way the agreement of the parties that they would "proceed with the construction of the pipeline as promptly as circumstances permit." [92]

Postponement of the construction of the Mediterranean pipeline.—The problems that had led to the delays in getting MEPL under way continued to hamper that project after the supplementary agreements were signed. The problem of the procurement of steel did not appear to be settled until sometime near January 1950, when arrangements were made for "steel pipe production to begin in the third quarter of 1951." This was thought to be the earliest date that construction of the pipeline could begin.[93] The most important factor in delaying the Mediterranean pipeline, however, was the difficulty in obtaining wayleaves from Syria and Iraq; and, in fact, it was the failure to obtain an acceptable wayleave convention from Iraq that led to the postponement of the pipeline project for a 3-year period, i. e., from 1951 to 1954. Thus, the present status of the pipeline project is suspensive until 1954 or such later time as the parent companies decide that conditions are suitable for its implementation.

After protracted negotiations, a pipeline convention was signed with Syria on June 7, 1949. It proved to be impossible to make a wayleave convention with Iraq, however, because MEPL was a side issue, as far as the Iraq Government was concerned, the main issue being the volume of domestic production of crude oil. Iraq was particularly anxious to push the development of production by the Basrah Petroleum Co., Ltd., an affiliate of IPC, because under the terms of this concession, they were to be paid as a royalty 20 percent of the oil produced.[95] The situation, therefore, was that—

from the outset the only attraction the MEP project has seemed to have for them was in connection with Basrah oil * * *. In short, every Iraqui interest seems to be against the wayleave itself except insofar as it brings with it hope of increased Iraqui production.

Thus, the negotiations throughout consisted for the most part of discussions of this matter, the attitude of the Iraq negotiators being

[91] Executive committee minutes of Jersey Standard, April 28, 1949.
[92] Provisions to this effect appear in each of the 4 supplementary agreements.
[93] Letter from C. L. Lockett to C. Saunders, January 23, 1950.
[95] See p. 95.

colored with the "fear that their aspirations for Iraqui production are still being ignored in certain quarters." [96]

The various proposals of the Iraq negotiators, therefore, were designed to achieve this one main purpose. They vigorously pressed a proposal that MEPL commit itself to reserve space for the transportation of Basrah oil. The MEPL negotiators, however, were instructed in the summer of 1948 that since IPC and its associated companies in Iraq were planning to develop broad-scale discussions with the Iraq Government in the near future, it was probable that a full understanding would be developed satisfying the Government's desires to see a "continued active development of the oil resources of Iraq." In these circumstances it was hoped that MEPL would not have to make a commitment to transport the oil of outsiders.[97]

While the negotiators held this matter in abeyance, it appears that the Iraq Government was not satisfied with the assurances given by IPC and was determined to press the point. The negotiations came to a halt after the following demands were made by the Iraq Minister of Economics:

> Firstly, that a letter be written by Sir William Fraser (and no one else), safeguarding production of the IPC fields.

Sir William, chairman of Anglo-Iranian, was specified because "everyone in Iraq believed that it was he and he alone who had the final word with the (IPC) group." The second demand was that MEPL "would be requested to assume the role of a common carrier." This actually meant that MEPL was to obligate itself to carry 8 million tons annually of Basrah oil,[98] i. e., 165,000 barrels daily.

Such a proposal was unacceptable to the parent companies of MEPL, since it would reserve nearly 30 percent of MEPL capacity for "outsiders." This would mean that each of them would have to surrender some part of their space for this purpose for an unknown period of time, since the Iraq negotiators had not mentioned any time limit.[99] It will be recalled that the owners of MEPL—Anglo-Iranian, Jersey Standard, and Socony—together owned 47.5 percent of Basrah Petroleum Co.[1] Hence they would have recovered only about half of the capacity they surrendered in this way to Basrah. Furthermore, Jersey Standard and Socony were committed to long-term contracts for the purchase of oil with Anglo-Iranian which would require their full share of MEPL capacity.[2]

The result of these proposals was to further delay the date of the beginning of the construction of MEPL. At a meeting of the board of directors of MEPL on June 1, 1949, a decision had already been made that "the implementation of our construction program be deferred for the present and reviewed at the next board meeting." [3] At a meeting on October 19, 1949, it was resolved "that the project should be delayed for a minimum of one (1) year, except as to continuance of

[96] Letter from L. C. Rice to C. L. Lockett, July 2, 1948.
[97] Letter from W. L. Butte to C. L. Lockett, July 29, 1948.
[98] Letter from D. R. deL. Macpherson to C. Saunders, February 24, 1950.
[99] Letter from C. L. Lockett to B. B. Howard, March 17, 1950.
[1] See chart 20, following p. 84.
[2] The situation was made more difficult by an additional Iraq proposal that "MEPL should transport at cost price the share of oil in kind allotted to the Government under the Basrah Convention," i. e., 20 percent of Basrah production. Since this oil could not be exported or sold for export by the Iraq Government but could be resold at the "well head market value" to the Basrah company, it was supposed that the purpose of this proposal was to enhance this value of the royalty oil as against that of the remaining Basrah production. Letter from H. W. Page to F. O. Canfield, March 27, 1950.
[3] Minutes of the meeting.

way leave negotiations in Iraq."[4] As a result of the Iraq proposals, an informal meeting of MEPL was held on April 4, 1950, where it was agreed to "discontinue negotiations indefinitely" and to "postpone MEPL for at least 3 years," i. e., construction would commence at the end of 1954 instead of 1951, as had been planned.[5]

SUMMARY

The contracts for the sale of crude oil discussed in this chapter represent still another intermingling of the interests of the major international oil companies in Middle East oil. Joint ownerships in the Middle East, which have resulted in extensive controls and restrictions on production, have been described in chapters IV and V. In addition to joint ownerships, the crude-oil supply contracts described in this chapter have provided another basis for joint control over oil production and marketing. These contracts have resulted in a sharing of oil production in Kuwait and Iran and a channeling of the oil to the market in the hands of firms able and interested in maintaining world prices and markets. These two instruments of control utilized in the Middle East, joint ownership and crude-oil supply contracts, have, in effect, served to complement each other in protecting the mutual interests of the international oil companies in the production and marketing of world oil.

The contracts provide for the sharing of large quantities of oil over a long period of time. Under the Gulf-Shell contract, Shell acquired control over 1¼ billion barrels of Kuwait oil owned by Gulf to be delivered over an open-end contract period of at least 22 years. Under the Anglo-Iranian-Jersey Standard-Socony contracts, Anglo-Iranian agreed to turn over to the two American companies 1.3 billion barrels of Kuwait-Iran oil over a 20-year contract period.[6] Thus these contracts result in the division of the production of Kuwait and Iran between the buyers and the sellers and, in effect, give them mutual and continuing interests in that production over a period of many years.

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[4] Ibid.

[5] Letter by C. Saunders to C. L. Lockett, April 5, 1950. Despite these decisions, however, the negotiations apparently were not immediately broken off, for further negotiations were held with Iraq representatives in London in July 1950. Letter from H. W. Page to B. B. Howard, July 19, 1950. About this time the basis of an agreement with the Iraq Government on an MEPL convention was being laid in IPC group discussions, where a representative of Jersey Standard was proposing that Basrah Petroleum Co. should agree to produce a minimum of 2,500,000 tons of crude annually and that, on this basis, there was a "chance of satisfying the Iraq Government that by 1954 total production from Iraq sources will be up to about 26,000,000 tons per year (540,000 barrels per day) and therefore, comparable with production from the other large Middle East sources." Letter from H. W. Page to F. O. Canfield, March 27, 1950. In this letter Mr. Page also said: "Naturally the Iraq Government would like to have maximum output of the Kirkuk pipeline plus 8,000,000 barrels from Basrah. This cannot be guaranteed by IPC at present. * * * I agree with de Metz that we must actually produce minimum concession requirements from Basrah (and probably settle on 2,500,000 tons per year as a minimum) if we are to get anywhere with the negotiations." These comments were followed by the remark quoted above. (It is difficult to tell whether he is here referring to MEPL or IPC negotiations.)

Due to the construction of the IPC 30-inch pipeline, such production would be possible if MEPL agreed to carry 2,500,000 tons annually of Basrah oil. Such a proposal was then under consideration by the representatives of the three companies which owned MEPL. Letter from H. W. Page to B. B. Howard, July 19, 1950. This last matter would appear to be cleared up by the decision of IPC to build a pipeline from the Zubair oil field in Basrah to Fao on the Persian Gulf. See map following p. 60.

[6] Anglo-Iranian thus acquired, through its contracts with Jersey Standard and Socony and through its 1933 agreement with Gulf, a powerful voice in determining the volume of production in Kuwait and Iran. Under its joint-ownership agreement with Gulf, Anglo-Iranian, with Gulf's consent, could substitute oil from Iran or Iraq for the Kuwait oil ordered by Gulf for itself or for Shell. Under the three contracts with Jersey Standard and Socony, Anglo-Iranian could supply the amounts contracted for from Kuwait or Iran at its option. Thus Anglo-Iranian could restrict or expand the production of Kuwait or Iran to meet the combined requirements of the five oil companies, i. e., Anglo-Iranian, Gulf, Shell, Jersey Standard, and Socony, in accordance with such "political" or other considerations as it judged to be important.

These mutual interests are typified by the unusual terms as to price that were agreed upon by the parties. Under the Gulf-Shell contract, no price is stated, but elaborate provisions were written providing for the division of profits between the two parties. The profits are determined and shared for the entire integrated process of producing, transporting, refining, and marketing for a minimum period of 22 years. Thus, to all intents and purposes, Gulf and Shell are joined together in a long-term integrated oil enterprise.

A cost-plus pricing principle was adopted for the three contracts for the purchase of oil owned by Anglo-Iranian. The price under the Jersey Standard and Socony first purchase agreements was fixed at the actual cost of production plus a fixed sum of money per ton, and under the Socony second purchase agreement, at actual cost plus one-third of the gross profit per ton realized on the crude oil. Such a pricing principle gives the purchaser a direct and strong interest in the costs of the seller, since the purchaser will benefit from any economies achieved by the seller in his operations. This interest was evidenced by the extensive provisions in the contracts setting forth the method for determining and allocating costs and for the delivery by Anglo-Iranian of "any and all information" relating to the cost elements entering into the price which Jersey Standard and Socony might "reasonably" request.

The significance of the contracts as instruments for the control of Middle East oil is further evidenced by the provisions restricting and controlling the marketing of the oil. Under its 1933 joint-ownership agreement with Anglo-Iranian, Gulf was bound not to disturb Anglo-Iranian's marketing position at any time or place, a restriction which had particularly restrained Gulf from entering markets "east of Suez." The terms and nature of the Gulf-Shell contract of 1947, however, imposed new restrictions on Gulf which largely superseded the restrictions of the 1933 agreement.[7] Thus if Gulf should use Kuwait oil to increase its business in any Eastern Hemisphere market at the expense of Shell, it would be penalized by an equivalent reduction of its deliveries to Shell. Similarly, Gulf would share, under the profit-sharing principle, in the losses occasioned by any price cutting in any Eastern Hemisphere market. Such price cutting would be expected to result if Gulf, in the utilization of Kuwait or any other oil, tried to invade any new markets or to increase its share of business in any established market. The Gulf-Shell contract thus appears to limit Gulf to those markets in which it holds a historic marketing position but to allow it, through the profit-sharing arrangement, to participate in the marketing of oil in those territories in which Shell holds a marketing position. The extensive joint marketing arrangements of Shell and Anglo-Iranian assured the integrity of the marketing positions of both. Thus the effect of these arrangements is to carry forward into the postwar period, the "as is" principle, to be described in chapters VIII and IX, preserving the historic position of participants in each market.

The areas in which Jersey Standard and Socony could dispose of the large quantities of oil acquired from Anglo-Iranian were similarly specified in the contracts. Not more than 5 percent of this oil could be distributed "east of Suez," a provision penalizing any excess ship-

[7] The Anglo-Iranian-Gulf agreement of 1933 was terminated on November 30, 1951.

ments to this area being inserted in each of the supplementary agreements to go into effect on January 1, 1952. Jersey Standard and Socony, under the first purchase agreement, were to distribute their oil in Europe and north and west Africa.[8] Socony, under the second purchase agreement, was to import its oil into the United States. In short, under these agreements, the three parties agreed upon the markets into which this oil was to flow.[9]

Thus the crude oil supply contracts, not only because of the large quantities of oil and the long periods of time that were specified, but also because of the unusual provisions as to price and marketing, constitute effective instruments for the control of Middle East oil. As such, they complement and increase the degree of joint control over Middle East oil resulting from the pattern of joint ownership described in the preceding chapters. The operation of these two instruments of control, in effect, brings the seven international oil companies, controlling practically all of the Middle East oil resources, together into a mutual community of interest.

[8] Socony was also permitted to distribute its oil in "the countries bordering on the eastern Mediterranean (including any islands within or adjacent to these areas)."

[9] Insofar as Jersey Standard was concerned, it had an established marketing position in each market within the permitted areas. Socony's business was not so extensive, however, in Europe as that of Jersey Standard, and the agreement does not restrict Socony to areas in which it already had a marketing position. For details on marketing positions before World War II, see ch. IX.

CHAPTER VII

JOINT CONTROL THROUGH PURCHASE AND SALE OF OIL IN VENEZUELA

INTRODUCTION

The use of crude-oil supply contracts to control the production of oil had effectively bound together the major oil interests in Venezuela a decade before this instrument of control was adopted in the Middle East. In Venezuela, however, such contracts were of a far more comprehensive nature, welding the interests of the parties together in an explicit joint enterprise lasting for the life of the concessions owned by the joint enterprise. Under this agreement the price paid by the purchasers, except for the sum initially paid as a consideration for the agreement, was merely the actual costs of production of the oil. The contracts, therefore, were again devices for sharing the ownership of the oil. Another important feature of the contracts was certain controls that were laid on production.

The Venezuelan petroleum industry has been an important factor in world petroleum markets for about 25 years. Throughout this quarter of a century of almost uninterrupted growth, three great international petroleum companies—Royal Dutch-Shell, Standard Oil Co. (New Jersey), and Gulf Oil Corp.—have been closely associated in the exploitation of this rich Venezuelan resource. These three companies have jointly maintained a pervasive control and influence over the Venezuelan industry in all its aspects, from exploration and development to the marketing of the end products.

During the period before World War II, practically all of Venezuelan petroleum had been produced in western Venezuela.[1] However, in the mid-1930's, a mounting tide of discoveries indicated that a resource of unpredictable magnitude and richness existed in eastern Venezuela. While practically all of these newly discovered oil fields were held by subsidiaries of Standard (New Jersey) and Gulf, it was evident that the impact of the new production upon world petroleum markets would concern all of the international oil companies, particularly Standard and Shell. Accordingly, the various subsidiaries of Standard, Shell, and Gulf entered into agreements designed to attain the following objectives:

1. The virtual elimination of Gulf as an independent factor in Venezuela. This was accomplished by the transformation of the Mene Grande Oil Co., Gulf's operating subsidiary in Venezuela, into a joint enterprise, owned and controlled by Gulf, Shell, and Standard (New Jersey), and by the attendant surrender by Gulf of valuable management prerogatives. Two so-called sale of oil agreements were the principal medium for this transformation.

[1] Specifically, up to October 1, 1938, nearly 93 percent of total accumulated production. More than 73 percent of accumulated production, as of this date, had come from the east shore of Lake Maracaibo alone. The Oil Weekly, November 7, 1938, pp. 16-27; December 19, 1938, pp. 18-26.

2. The control and regulation of petroleum production of all Venezuela, eastern and western alike, so that Venezuelan output would, at all times, accord with the current world market situation as seen by the producing companies. A production quota system was set up to achieve this goal.

3. The control and regulation of the development of the newly discovered eastern Venezuelan oil fields. This was accomplished partly by the re-creation of Mene Grande as a joint enterprise, partly by the production quota system, and partly by the merging of a major portion of the eastern Venezuelan holdings of Mene Grande and of Standard (New Jersey) into a joint enterprise.

BACKGROUND OF THE AGREEMENTS

The agreements that are to be described were designed to meet a specific situation and to gain specific ends. They were signed in December 1937, a year which is thus of critical importance in the analysis of the Venezuelan oil industry. The following discussion presents background information necessary to an understanding of the purposes of the parties to these agreements.

Identification list of companies

The principal *operating* companies in Venezuela in 1937, with identifying abbreviated names, were as follows:

(*a*) Gulf Oil Corp. subsidiary: Mene Grande Oil Co., C. A. (Meneg).

(*b*) Standard Oil Co. (New Jersey) subsidiaries:
- Lago Petroleum Co. (Lago).
- Standard Oil Co. of Venezuela (SOV).
- Creole Petroleum Co. (Creole).

(*c*) Royal Dutch-Shell group subsidiaries:
- Venezuelan Oil Concessions, Ltd. (Shell).
- Caribbean Petroleum Co., Ltd. (Shell).
- Colon Development Co., Ltd. (Shell).

In addition, two companies whose principal activities were in other countries entered into the Venezuelan picture by virtue of participation in the agreements. These were

(*d*) Standard Oil Co. (New Jersey) subsidiary: International Petroleum Co., Ltd. (International).

(*e*) Royal Dutch-Shell group subsidiary: N. V. Nederlandsche Olie Maatchappij (NOM).

The properties and business of these companies at the time the agreements were concluded in December 1937 were as follows:

Mene Grande Oil Co. (Meneg).—Meneg has been a 100-percent subsidiary of the Gulf Oil Corp. throughout its existence.[2] Nevertheless, at the time the various agreements were signed in December 1937, Meneg already represented a tangle of corporate interests, its control over its properties and property interests having been diluted by a sharing of rights and benefits with others. With its re-creation as a joint enterprise, however, Gulf's interest in Meneg was diluted further.

During its entire existence, Meneg has been engaged solely in the business of producing crude oil, or acquiring it through share inter-

[2] It is 100-percent owned by the Venezuelan Gulf Oil Co., a 100-percent owned subsidiary of Gulf.

ests, and transporting that oil by pipeline or lake steamer to shipping points on the Venezuelan coast.

As of December 1, 1937, Meneg owned varying kinds of interests in exploitation concessions in Venezuela totaling about 4,300,000 acres in extent.[3] Only a small part of this, comprising about 109,000 acres, was in western Venezuela, chiefly in the oil-rich Lake Maracaibo area. Other corporations owned royalty and other interests in at least 40 percent of this property.[4] Until 1938, practically all of Meneg's production came from these prolific acres.

In eastern Venezuela, Meneg owned or had interests in about 4,191,000 acres of exploitation concessions.[5] These properties fell into three general classes: (*a*) Meneg held title to about 1,112,000 acres of this on its own account, (*b*) it held title to about 1,148,000 acres for the joint account and at the joint expense of itself and the Standard Oil Co. of Venezuela (SOV), and (*c*) it held a 50-percent interest in about 1,931,000 acres, title to which was held by SOV similarly for joint account.[6] Besides these exploitation concessions and interests, Gulf owned on its own account about 50,000 acres of exploration concessions and held joint interests with SOV in about 415,700 acres of exploration concessions. All of the joint properties of Meneg and SOV were brought into the Meneg-SOV agreement as described below.

In December 1937 Meneg had a total production of 70,000 barrels of crude oil daily, all but token amounts being produced on its Lake Maracaibo properties. Its properties and interests in eastern Venezuela, moreover, promised to be of great value.

Standard Oil Co. of Venezuela (*SOV*), *Lago Petroleum Co.* (*Lago*), *and Creole Petroleum Co.* (*Creole*).—These three companies were the principal subsidiaries of Standard (New Jersey) in Venezuela in December 1937. Standard Oil Co. of Venezuela has already been mentioned as the principal partner with Meneg in the ownership and operation of various concessions in eastern Venezuela. SOV also operated concessions on its own account in eastern Venezuela and a comparatively small acreage in western Venezuela. Lago Petroleum Co., operating entirely in the rich oil fields of western Venezuela, produced nearly twice the volume of crude oil produced by SOV. Lago also operated a small refinery and marketing organization for the Venezuelan trade. Both Lago and SOV transported their crude oil production by pipeline and lake steamer to the Venezuelan coast, whence it was shipped to the large refinery at Aruba or to other refineries of Standard (New Jersey) in the United States and Europe.

Creole Petroleum Co. acted, in 1937, chiefly as a holding company subsidiary of Standard (New Jersey). It controlled 100 percent of

[3] Mene Grande Oil Co., Identification List of Oil Concessions in Venezuela.

[4] Royalty interests were and are still held in some of these properties by Venezuelan Petroleum Co. (subsidiary of Sinclair Corp.) and by the Maracaibo Oil Exploration Co. (See Moody's Industrials, 1937 and 1950.) Gulf's prospectus, dated June 7, 1943, pp. 29–30, reveals that the Creole Petroleum Co. (Jersey Standard) held a royalty interest in some properties, and had a joint (50 percent) interest in the crude oil produced on other properties of Meneg, paying half the costs incurred. In 1937 these three companies alone held interests in 40–50 percent of Meneg's properties in western Venezuela.

[5] Identification list of oil concessions in Venezuela.

[6] In addition to this, SOV in December 1937, was in the process of transferring about 17,000 acres of exploitation concessions to the joint account. Ibid.

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SOV and owned the royalty and joint interests in Meneg's Lake Maracaibo properties mentioned above.[8] In 1943, all of Standard (New Jersey) properties and interests in Venezuela, except certain interests in Meneg,[9] were consolidated into Creole, which became Standard's sole operating subsidiary in that country. Standard's ownership of Creole increased from 74.62 percent in 1937 to 93.12 percent in 1949.

Venezuelan Oil Concessions, Ltd., Caribbean Petroleum Co., and Colon Development Co., Ltd. (Shell).—These three subsidiaries[10] of the Royal Dutch-Shell group operated in western Venezuela, and were principally in the business of producing crude oil and transporting it to shipping points. Since 1938, certain Western Hemisphere assets of the Shell group, including its interests in Meneg, have been transferred or consolidated into the Caribbean Petroleum Co., the name of this company being changed in 1948 to the Shell Caribbean Petroleum Co.[11]

The International Petroleum Co. (International).—International was a fully integrated petroleum enterprise at the time the agreements were concluded. It was engaged in all phases of the petroleum business from crude oil production to the marketing of finished petroleum products. It operated in Colombia directly and in Peru through the medium of the Tropical Oil Co., a 99.9-percent owned subsidiary.[12] It became interested in Venezuelan crude oil by virtue of its purchase agreement with Meneg, which is described below. The Imperial Oil Co., Ltd. (Canada), owned 60.09 percent of International's common stock in 1937 and an unstated but substantial amount of the preferred stock, which elected two-thirds of the board of directors.[13] Standard Oil Co. (New Jersey), in turn, owned 69.79 percent of Imperial's common stock in 1937. In 1948 Imperial sold all its holdings of International stock. Standard emerged from this and other related transactions with 83.58 percent ownership of International.

The N. V. Nederlandsche Olie Maatchappij (NOM).—NOM did not own or operate petroleum concessions in South America, but rather, was a refining and transportation subsidiary of the Royal Dutch group.[14] The NOM and the interests it had acquired in Meneg under the agreements described below were consolidated into the Shell Caribbean Petroleum Co. in 1948.

The Venezuelan petroleum industry in 1937.—Venezuelan oil fields yielded about 9.1 percent of the total world production of petroleum in 1937.[15] Practically all of this production was in excess of domestic requirements and hence was exported for ultimate sale in world

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[8] See footnote 2, p. 165.

[9] These interests in Meneg were held by International under the agreements described in these pages.

[10] Royal Dutch-Shell, in 1950, owned 100 percent of Venezuelan Oil Concessions, Ltd., and of Caribbean Petroleum Co., and more than 90 percent of the ordinary (voting) stock of Colon Development Co., Ltd.

[11] Included in its assets is Shell's 65.44 percent interest in the Shell Oil Co. (United States). Shell's transfer of its interests in Meneg to Caribbean was consented to by Meneg in a letter dated October 15, 1948. This consent was necessary under the Meneg-International-NOM agreement of January 28, 1939. See below, p. 179.

[12] In 1937 International produced 100 percent of Colombian and 83 percent of Peruvian crude oil production. The Oil Weekly, February 21, 1938, p. 160, and April 11, 1938, p. 65. International's relative position in 1949 was 80.8 percent in Peru and 42.3 percent in Colombia, where new oil fields, controlled by Shell, and by the Texas Co. and Socony-Vacuum jointly, have come into production. World Oil, July 15, 1950, pp. 124 and 139.

[13] Moody's Industrials, 1941 gave this ownership as 99.99 percent.

[14] It operated in the Dutch West Indies.

[15] World Oil, July 15, 1950, pp. 44-46. This was measurably greater than the combined yields of the important producing countries of the Middle and Far East.

petroleum markets. Thus, Venezuelan oil probably accounted for about 40 percent of world trade in petroleum in 1937.[16]

In 1937 and, in fact, throughout the period between World War I and World War II, more than 99 percent of the production of this country was owned by the three companies that dominated the Venezuelan industry.[17] During the late 1930's, subsidiaries of Standard Oil Co. (New Jersey) produced from 48 to 53 percent of Venezuelan production, Shell subsidiaries from 35 to 38 percent, and the Gulf subsidiary from 10 to 14 percent.[18]

In 1937 more than 73 percent of Venezuelan production came from the Lake Maracaibo region, and about 12 percent from other oil fields in western Venezuela. Practically all the remaining production came from a large oil field in eastern Venezuela.[19] For the most part, these fields produced heavy, low-gravity, low-value oils. Commercial production of the newly discovered light oils of eastern Venezuela had barely begun and could not be an important factor for several years.

Western Venezuela.—The most important oil fields of Venezuela, the rich properties located on the eastern shore of Lake Maracaibo, were and are owned by subsidiaries of Shell, Jersey Standard, and Gulf [20] under a pattern of ownership that has lent itself to close cooperation among the three companies. These properties, under the pattern that had developed, were each divided into three roughly parallel strips, one owned by each company.[21] According to the annual reports of Venezuelan Oil Concessions, Ltd., Shell's subsidiary in these oil fields, the three companies had agreed upon a program of "offset development" in this area within agreed-upon "zones" or "areas open to development." In this way, it was said, "wasteful" practices were eliminated, and drilling was carried on under "conditions of sound well spacing." [22] The annual report for 1937 stated:

> Development of the fields of offset character in the Maracaibo Basin remained confined to zones agreed upon by the Lago Petroleum Corp., the Mene Grande Oil Co., and this company.[23]

The annual report for 1938 stated:

> Close cooperation was maintained locally with the Lago Petroleum Corp. and Mene Grande Oil Co., especially in all matters pertaining to the development of areas of offset character. Strips of territory 2 kilometers in length at

[16] Total international trade in petroleum in 1937 was 469,132,000 barrels. The Oil Weekly, February 27, 1939, p. 48. Venezuelan exports of crude oil, in 1937, totaled 178,312,000 barrels (about 95 percent of production). In addition, Venezuela usually exported a large proportion of the refined products manufactured from the 5 to 8 percent of its crude oil that was run to stills in the pre-World War II period. Bureau of Mines, International Petroleum Trade, September 30, 1941, p. 257.

[17] Even the production accruing to the two "independent" petroleum companies then owning properties in Venezuela was largely subject to control by Standard (New Jersey) and Shell. Shell held and holds crude-oil purchase options upon the output of British Controlled Oilfields, Ltd., while Standard (New Jersey) manages some of this company's properties and all of the property of North Venezuelan Petroleum Co., Ltd., on a royalty basis. Moody's Industrials, 1938 and 1950.

[18] The Oil Weekly, February 28, 1938, pp. 52–54; August 22, 1938, pp. 37–38; July 24, 1939, pp. 32–34.

[19] Idem.

[20] The subsidiaries were, respectively, Venezuelan Oil Concessions, Ltd., Lago, and Meneg.

[21] The ownership pattern in these areas was described in 1931 as follows: "The Standard Oil Co. of Indiana' through its subsidiary the Lago Petroleum Corp., controls the concessions under the lake bed, except the 'marine zone,' a strip 3,300 feet wide extending under the water around the entire shore of the lake, which is controlled by the Venezuela Gulf Oil Corp., subsidiary of the Gulf Oil Corp. of Pennsylvania, and the Creole Petroleum Corp., subsidiary of the Standard Oil Co. of New Jersey. The Royal Dutch-Shell Co., through its subsidiaries, controls the concessions on the shore." U. S. Tariff Commission, Report to the Congress on the Cost of Crude Petroleum, Rept. No. 4, second series, pp. 18–19. Lago was sold to Jersey Standard in 1932. (See above, p. 70.) This same ownership pattern was later extended to new oil-field developments in this area, such as that at Buchaquero, according to a report by W. V. Gross, foreign editor, The Oil Weekly, November 18, 1938, p. 71.

[22] The Petroleum Times, June 10, 1939, p. 764.

[23] Ibid., June 11, 1938, p. 765.

Tia Juana and 5 kilometers in length in southern Lagunillas were added to the areas open to current development.[24]

The effect of this cooperative program tended to be a unified and harmonious development whereby the companies maintained their relative positions insofar as the "fields of offset character" were concerned.

In March 1938, Jersey Standard owned about 40 percent of the crude oil produced from the jointly owned Lake Maracaibo oil fields; Shell about 38 percent, and Gulf about 22 percent.[25] The major companies obtained most of their Venezuelan production from these properties. More than two-thirds of Shell's Venezuelan production, about 70 percent of Standard's production, and close to 100 percent of Gulf's production came from these jointly owned fields in 1937.[26]

Most of the western Venezuelan petroleum production from other oil fields was produced by Shell, with small proportions owned by Standard (New Jersey) and by two small companies. The two small companies together accounted for about 0.3 percent of total Venezuelan production in 1937.

Eastern Venezuela.—For nearly a decade prior to 1937, the only oil field in eastern Venezuela had been the highly productive Quirequire field owned by Standard (New Jersey).[27] However, this property, like that in western Venezuela, generally produced only heavy oils, used principally to manufacture fuel oils and related low-value products.[28]

Eastern Venezuela was the center of the most active exploratory and developmental work.[29] Standard (New Jersey) already had developed small production at two new oil fields, and Gulf was active at Oficina, which was to become the most productive of the new fields. Drilling was in progress or planned at eight sites or more, four of which were to become important producers, and no less than seven geophysical crews were operating in eastern Venezuela.

There was every indication that these new oil fields would yield more valuable oils than those of western Venezuela—lighter oils that would be more suitable for high-value products.[30] The first commercial production of these "Oficina" crudes, as determined officially by the Venezuelan Government, established the fact that they were 40 to 50 percent more valuable than the best Maracaibo crudes, and 50 to 90 percent more valuable than the general run of Maracaibo and Quirequire crudes.[31]

To sum up, in 1937 more than 99 percent of Venezuelan production was directly controlled by Shell, Standard (New Jersey), and Gulf subsidiaries. About 73 percent of this was recovered from lands having a closely integrated ownership pattern in which the three shared, and the remainder was separately produced by Shell in western Venezuela and by Standard (New Jersey) in eastern Venezuela.

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[24] Ibid., June 17, 1939, p. 785.
[25] The Oil Weekly, June 6, 1938, p. 58.
[26] Ibid., February 21, 1938, p. 52.
[27] Standard's subsidiary in eastern Venezeula was SOV.
[28] The Oil Weekly, November 7, 1938, pp. 16–27; December 19, 1938, pp. 18–26; International Petroleum Trade, May 31, 1941, p. 152. These crudes had gravities of 11.5° to 20° API. However, there was a small production at Cumarebo with a gravity of 50° API, and the LaRosa crudes had gravities ranging from 12.9° to 30° API.
[29] The Oil Weekly, November 7, 1938, pp. 16–27.
[30] Idem.
[31] International Petroleum Trade, September 30, 1941, p. 255.

MARKETS FOR VENEZUELAN OIL IN 1937

The discovery of additional reserves of high-value oil in eastern Venezuela presented the major Venezuelan companies with a difficult problem: How could this new production be marketed without disturbing the established price structure? Existing capacity in Venezuela was by no means fully utilized: in late 1937 and in 1938, fully 17 percent of the capacity of the Lake Maracaibo fields was shut in.[32] By this time, also, the marketing cartels described in chapter IX had been in operation for several years in Europe and South America. Existing world resources were more than adequate to meet the needs of Venezuela's natural markets.

At the time, the United States offered only a small and limited market for Venezuelan oil. Among the various actions taken in the early 1930's to stabilize United States petroleum markets were two steps designed to limit imports, namely:

(*a*) A substantial increase in excise taxes on crude oil and refined products, when imported for domestic consumption, made in the Revenue Act of 1932;

(*b*) A voluntary agreement made by the principal importing companies with the Secretary of the Interior in 1933 to limit imports of crude oil and refined products to the average for the last 6 months of 1932.[33] The provisions of this agreement, which was made in the midst of agitation by "independent producers" for emergency legislation restricting or laying prohibitive taxes on imports, were later incorporated into the Petroleum Code under the National Industrial Recovery Act.[34] The import quota under the NIRA was fixed at 4.5 percent of domestic production, and even after the NIRA was declared unconstitutional, imports into this country continued at about the same levels.[35] Thus, total imports of crude oil and refined products, including imports bonded for reexport or for supplies for ships in foreign trade (bunker oils), in 1933 were 4.8 percent of domestic crude-oil production; in 1937, 4.6 percent; and in 1939, 4.7 percent.[36] This restricted importation was attributed to "voluntary action" on the part of the few oil companies dominating crude-oil production in Venezuela and Latin America, and which were also major producers and refiners in the United States.[37] A formal restriction of imports of crude oil, topped crude, fuel oil, and gas oil to 5 percent of the quantity of crude oil processed in domestic refineries during the preceding calendar year was included among the provisions of the reciprocal trade treaty with Venezuela in 1939. This quota arrangement was suspended in the reciprocal trade treaty with Mexico in 1943.

In 1937, total imports of crude oil and petroleum products into the United States were about 4.6 percent of domestic production.[38] More than 99 percent of these imports consisted of crude oils, residual fuel oils, and other unfinished oils. About 87.5 percent of the total origi-

[32] The Oil Weekly, February 21, 1938, p. 52; December 19, 1928, pp. 18-26.
[33] Testimony of Joseph E. Pogue. TNEC hearings, p. 7447.
[34] U. S. Tariff Commission, War Changes in Industry Series, Report No. 17, Petroleum, pp. 76-77.
[35] Idem.
[36] Ibid., p. 46. The Tariff Commission reported that "since 1933 the bulk of the imports of crude oil have been brought in by two companies, Standard Oil Co. (New Jersey) and Gulf Oil Corp. Five other major companies * * * have imported relatively small quantities of crude oil. Standard, Gulf, and Shell have been principal importers of fuel oil." Ibid., p. 77.
[37] Ibid., p. 77. See also, B. M. Murphy (ed.), Conservation of Oil and Gas, p. 657.
[38] All figures in this paragraph calculated from data in Foreign Commerce and Navigation of the United States, 1937, p. 179, and The Oil Weekly, February 27, 1939, p. 56.

nated in Venezuela, being shipped directed to this country or through the Netherlands West Indies; 11.5 percent came from Mexico; and only about 1 percent from all other countries. The imports coming directly or indirectly from Venezuela amounted to about 28 percent of that country's production in 1937.[39]

In effect, therefore, the world's largest market for petroleum was shut off from the major fraction of Venezuelan production. The impact of the new production was, therefore, primarily in markets outside the United States. While all three of the Venezuelan major producers were concerned about this problem, Shell was probably in the most vulnerable position, since in 1937 the Royal Dutch-Shell group accounted for 22.4 percent of world petroleum production outside of the United States.[40]

SALE OF OIL AND RELATED AGREEMENTS

To bring this potentially explosive situation under control, various agreements were concluded in 1937 and 1938 by the Venezuelan subsidiaries of Standard (New Jersey), Royal Dutch-Shell, and Gulf. Two of these agreements, those known as the principal and main agreements, received some attention in the trade press,[41] where they were represented as being "contracts" for the purchase of crude oil from Mene Grande. In the various annual reports and other public documents of the companies and in such publications as Moody's Industrials, they have been referred to as "long-term sales contracts" and the like. As a matter of fact, however, they represent a far broader and more complex interchange among the parties than is implied in an ordinary business transaction. More than this, related agreements, less well known to the public or secret, were concluded at the same times as the principal and main agreements. All of these agreements were designed to be read together as a unified instrument, constituting a broad program for the control of Venezuelan crude-oil production. The effect of this group of agreements was to regulate the development and output of the Venezuelan industry so that a "fair" relationship would be maintained at all times with total world production, outside of the United States, and to divide the *allowable production* among the participants to the agreements. The nature and wording of a number of their provisions suggest that similar agreements, understandings, controls, or regulations were existent or contemplated in other petroleum producing areas.

The various agreements of 1937 and 1938 were designed to perform two limited and specific functions: (1) the transformation of the Mene Grande Oil Co. into a joint enterprise of the three participants in the agreements, leaving it only the nominal character of a wholly owned subsidiary of the Gulf Oil Co.; (2) the fixing of production quotas for Meneg and Jersey Standard subsidiaries for a minimum period of 12 years on a ratio basis, the quotas being fixed so as to maintain a *"fair" relationship* of the parties to all Venezuelan production and of all Venezuelan production to total world crude oil pro-

[39] In 1938, with Mexico largely eliminated from the United States market, the share of Venezuela and the Netherlands West Indies rose to more than 90 percent of imports. This meant little or no change in the volume of Venezuelan imports, however, as the total volume of United States production and of imports was lower in 1938 than in 1937. U. S. Senate Committee Investigating Petroleum Resources, hearings, Petroleum Requirements—Postwar, 1946, p. 103.

[40] The Oil Weekly, July 25, 1938, p. 240.

[41] See, for example, The Oil Weekly, December 26, 1938, p. 48, and The Petroleum Times, December 31, 1938, p. 864.

duction outside of the United States, *"to the extent that it is within the control of Meneg and Lagosov* [Standard (New Jersey)]." [42]

Although the various agreements were a unified whole, the provisions of the agreements may be most conveniently discussed under the functional headings Nos. (1) and (2) above.

The joint enterprise

The Mene Grande Oil Co. (Meneg) was transformed, in effect, into a joint enterprise of Gulf, Standard (New Jersey), and Shell through three agreements:

(1) The Meneg-SOV agreement, December 15, 1937,

(2) The Meneg-International principal agreement, December 15, 1937,

(3) The International-NOM main agreement, November 30, 1938.

As has been noted, these agreements left undisturbed Gulf's 100-percent ownership of the shares of stock of Meneg. However, they transferred an undivided one-half interest in all the physical assets and production of Meneg to Standard (New Jersey) and Shell, with the result that Meneg retained only a one-half interest in all the properties and rights to which it held title. In fact, to all intents and purposes Gulf became a junior partner in the enterprise, since important management functions were transferred to the other two parties.

The Meneg-SOV agreement of December 15, 1937.—On December 15, 1937, simultaneously with the signing of the principal agreement and the ratio agreement in Toronto, Canada, both described below, a third agreement was signed in Caracas, Venezuela, by Meneg and the Standard Oil Co. of Venezuela (SOV). This agreement was apparently designed to regulate and bring up to date an earlier series of agreements between these parties, the details of which are not in the possession of the Commission.[43]

The main purpose of the agreement was declared to be the achievement of "economy of operation" of certain concessions owned by the two parties in eastern Venezuela.[44] To that end, the management and operation of these "pooled" properties were coordinated and intermingled, so that, in effect, a joint enterprise emerged.

"Pooled concessions": The properties held by Meneg and SOV for their joint benefit and at their joint cost were declared to be "pooled concessions." [45] As has been indicated, these include about 3,078,000 acres in exploitation concessions, about 17,000 acres of exploitation concessions in process, and about 415,700 acres of exploration concessions. SOV's share of oil from about 61,700 acres of exploitation concessions held jointly with third parties was included in the terms of the agreement.[46]

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[42] Quoted more fully on p. 183 below. [Italics added.]

[43] An agreement between Meneg, International, and NOM, dated February 10, 1939, refers to the "so-called B/L agreement of November 3, 1933, and existing amendments thereto." Likewise, a letter from International to NOM, dated November 30, 1938, refers to Meneg-SOV contracts dated November 3, 1933. September 23, 1936, and December 15, 1937. The context suggests that these 2 references refer to the same documents, and it also implies the conclusion stated.

[44] Art. I.

[45] Art. 2. The properties, as listed in schedules A and B to the agreement, are identical with those indicated as joint concessions in the Identification List of Oil Concessions in Venezuela.

[46] These "pooled concessions" appear to have included both proven oil fields, e. g., the Oficina field of Meneg, and unproven areas where drilling was being actively carried on. It may be noted that not all the holdings of Meneg and SOV in eastern Venezuela were pooled, each retaining some properties and interests in properties on their separate accounts. It was provided that any pooled concessions could be eliminated from the agreement by mutual consent of the parties (art. 3). Similarly, any concession or interests in concessions hereafter acquired by the parties could be made a pooled concession (art. 4). Pooled concessions could be surrendered by mutual consent, or, if one party would not give its consent, sole ownership and control of the concession would pass to the party wishing to retain it (art. 4).

It was agreed that the party owning title to and operating each pooled concession or concession interest would transfer one-half of its production or share of production to the other. Thus, regardless of which party held title to concessions which subsequently should prove to be oil producers, both of the oil companies would share equally in the oil produced on the pooled concessions.[47]

The consideration paid for the transfer of this oil consisted of the reciprocal obligations of the parties to make such transfers plus a reciprocal obligation to share in the costs of operation of the pooled concessions.[48] Thus, while the ownership of the titles to these pooled concessions was undisturbed by the agreement, all the rights, benefits, burdens, and obligations arising out of the ownership of the concessions were shared on an equal basis between the two parties. In effect, therefore, the properties became jointly owned and operated concessions of the two companies.

Joint management of the pooled concessions: With the creation of a de facto joint ownership of the pooled concessions by Meneg and SOV, there was created similarly a de facto joint management organization of the concessions. Nominally, each concession was operated by its separate "owner," but in fact the management, manpower, and material resources of the two partners were pooled in the operation of the pooled concessions.

A committee of four was designated as the top management of the pooled concessions. Two members of the committee were to be nominated by each party, each such group, however, to have but one vote.[49] The powers of this committee were stated as follows:

> Committee shall *allocate areas for development* and select the operator therefor, and shall have the *exclusive right and obligation to decide all questions of policy, operations, control and management* of the interests acquired under this agreement.[50]

The entire control and management, therefore, of those properties of Meneg and SOV designated as pooled concessions passed to a joint management committee of the two companies. The provision that the representation of each company should have but one vote was designed to prevent unilateral decisions and to insure that both of the parties had an equal voice in the proceedings.[51]

More than a union of top management was contemplated by the agreement, however. The accounting manual attached to the agree-

[47] Royalties paid in kind, or the ratable proportion of such royalties in the case of concessions held jointly with outsiders, were to be deducted before the production was measured. Cash royalties were to be included in the costs of operation as a carrying charge (arts. 3 and 4).

[48] Costs were defined to include the costs of acquiring each pooled concession and of maintaining title thereto, carrying charges of the concessions, including taxes, cash royalties, and all costs of operation, and the costs of development of the concessions (art. 4). An accounting manual with detailed instructions for determining and allocating the amounts of these costs was included in the agreement (art. 3).

[49] Art. 5. These nominees, of course, were top officials of Meneg and SOV.

[50] Ibid. [Italics added.] The article also states: "In principle, it is contemplated that the parties shall operate equal parts of the total area insofar as practical."

[51] Novel provisions were included to deal with situations where disputes or disagreements arose with respect to any particular area included under the agreement or in those cases where decisions could not be reached, i. e., cases where a party could not or would not cast its vote with respect to an area. Such cases were to be referred to a special arbitration committee of two. High officials of Standard (New Jersey) (W. S. Farish) and of Gulf (F. A. Leovy) were designated as the first members of the committee. If this committee could not come to an agreement, "then either party may make to the other in writing *a give or take proposition* for the purchase of the other party's interest or the sale of its own interest hereunder, with respect to the areas in question" (art. 5). [Italics added.] The other party was given a 30-day period in which to accept the one alternative or the other, and if it took neither alternative, it would have the effect of an *acceptance* of the alternative of selling its interest at the price offered. The purpose of these provisions was to force a settlement of all issues arising in connection with the pooled concessions, while insuring that, in the event of serious disputes, none of the rights and benefits in the concessions would be transferred to outsiders.

ment suggests that the material and manpower resources of the two companies were to be pooled in the operation of the concessions. Detailed instructions are given for allocating costs incurred by pooled labor, equipment, and professional and technical services in the developmental projects, the drilling of wells, and so on. While separate organizations were to be maintained, in many respects they would act jointly and as one.

The Meneg-International (principal) agreement.—On December 15, 1937, representatives of Mene Grande Oil Co. and of another Jersey Standard subsidiary, International Petroleum Co., Ltd., signed in Toronto, Canada, an agreement known among the parties as the principal agreement. A number of supplementary agreements, designed to clarify or to spell out in some detail the meaning of various provisions of the principal agreement or to set up administrative procedures and machinery for its operation, were signed on the same date and at later dates. These agreements were represented to the public as a contract for the sale of oil between Meneg and International, an arm's-length bargain in which Meneg gained a long-term outlet for its surplus crude-oil production and International was assured of an additional supply of crude to meet its own and its customers' long-range requirements.[52] If the principal agreement is read in conjunction with the other agreements, however, the provisions of that agreement appear to be part of a broad merging of interests going far beyond that implied in the Meneg-SOV agreement.

Sale of oil: The provisions relating to the sale of oil constitute generally an agreement of Meneg to sell, and of International to buy, one-half of Meneg's total net production of crude oil, the sale to commence on December 15, 1937.[53] No commitment was made in the agreement as to the quantities of oil to be made available from year to year, this matter being dealt with in the ratio agreement discussed below. The sale was to continue throughout the life of any concessions or interests owned or subsequently acquired by Meneg.[54]

No machinery was created for determining the price to be paid for the oil or its value, nor was any price or value agreed upon, as the oil was to be sold at cost of production, an additional consideration being paid for the agreement as a whole including the sale of oil provisions.[55]

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[52] See the statement on the Gulf Oil Corp. in Moody's Industrials, 1938 and subsequent years. In 1938 the following remarks were made: "No change in ownership of Mene Grande's oil concessions was involved and it retains control of the development and operations of the properties." Cash payments were represented as being in consideration of and advances on crude oil to be delivered. At the time Gulf filed its first registration statement under SEC regulations, in connection with its stock issue of 1943, full details of the principal agreement were made public.

[53] Net production includes Meneg's total production, after deducting royalties paid in kind, from properties owned for its sole benefit, and Meneg's share of the production, after deduction of that portion of royalties paid in kind applicable to that share, from concessions in which Meneg owns an interest (i. e., joint properties to which Meneg holds title) or in which Meneg owns an interest in production (i. e., joint properties to which others hold the title).

[54] The life of the agreement was declared to be that of the life of any or all of the various concessions and interests covered by the agreement. This includes all concessions and interests owned by Meneg for its own account or jointly with SOV or other third parties on December 15, 1937, and all such properties acquired after that date and for which International has paid half the costs of acquisition. Extension of the life of any of these concessions and interests would operate as an extension of the life of the agreement. *No right of cancellation* of the agreement prior to this defined termination was granted to either party (art. 17).

[55] The consideration paid for the sale of oil and for the agreement is described more fully on p. 176 ff. Further provisions in the sale of oil agreement include:

(1) In the event that Meneg, for any reason, failed to deliver any part of the crude oil accruing to International under the agreement, it was agreed that International, upon request, would receive an equivalent volume of oil from the Standard Oil Co. of Venezuela (SOV) taken from Meneg's share of the production from joint properties held by SOV.

(2) Royalties paid in cash rather than in kind by Meneg on its production and the ratable share of such royalties paid on production from joint properties were to be included in the carrying charges.

Sale of physical assets: Included in the sale to International was "*an undivided one-half interest in Meneg's physical plant and equipment of every character.*" This was defined so as to include not only such tangibles as "marine equipment, tanks, and pipelines, * * * fee lands, * * * also materials and supplies on hand in Venezuela," but also such rights and interests as "surface leases, easements, licenses, and permits." Excluded from the sale were only a refinery site and the oil stored in tanks located off the concessions or in transit to shipping points.[56] This undivided one-half interest was to be recorded in Meneg's books of account at one-half the net book value of this property; i. e., Meneg's assets would continue to be held in Meneg's name, but a one-half interest in those assets would be recognized as "vested" in International.

A similar "undivided one-half interest in all property of every kind hereafter acquired by Meneg, of which one-half the cost is * * * reimbursed Meneg by International" was also transferred in the sale; i. e., International was to participate at its option after December 15, 1937, in all property acquired by Meneg.[57] To record and represent International interests in Meneg's assets, special reserve accounts were established and maintained in Meneg's books and auxiliary records, these accounts being "adjusted monthly, so as to represent 50 percent of the net book value of property * * * in which International has the aforesaid interest." [58]

The surrender of management prerogatives: The Meneg-SOV agreement brought under the joint management and effected a joint ownership by the two companies of exploitation concessions totaling some 3,079,000 acres and exploration concessions totaling about 415,700 acres. It was contemplated that other concessions would be brought into the joint venture from time to time. Meneg retained its independent control of 1,112,000 acres of exploitation concessions and 50,150 acres of exploration concessions in eastern Venezuela and of its holdings in western Venezuela.[59]

In the Meneg-International principal agreement, Meneg traded away this equal voice in the "pooled concessions" and also its freedom of action with respect to its wholly controlled concessions. In doing so, it surrendered to International the ultimate and basic management rights over the control and direction of operations and the disposition of concessions.

In order to exercise the management rights granted to International and to safeguard its interests in Meneg, International required complete and intimate acquaintance with all of Meneg's information and activities. Meneg, therefore, agreed to allow International or its nominee [60] "full and complete access to all parts of the properties" of which Meneg had sole control, and to "all geological and any other information possessed by or available to Meneg and relating thereto." This grant included full access to Meneg's books of account relating to all its operations.[61] Similar provisions were unnecessary with respect to the "pooled concessions" since SOV participated fully in their ownership and management by virtue of the terms of the

[56] Art. 3. [Italics added.]
[57] Idem.
[58] Supplementary agreement (Accounting Requirements and Instructions * * *) dated January 29, 1938, sec. III (4).
[59] See below, p. 165.
[60] I. e., Standard operating subsidiaries in Venezuela.
[61] Art. 11.

Meneg-SOV agreement. Standard (New Jersey) therefore, through one subsidiary or another, had access to every detail of Meneg's business.

International was granted a right of general supervision over Meneg's operations and an absolute veto over certain important matters. Meneg agreed to prepare and submit to International, on or before November 1 of each year, beginning in 1938, a "budget of capital and operating expenditures for joint account," [62] i. e., a budget covering all of Meneg's proposed capital and operating expenditures, and a "statement of general operating policy." Both the budget and the policy statement were to be prepared for the ensuing calendar year.[63] Neither document was to be adopted until after it had been discussed by representatives of Meneg and International.

It was provided, moreover, that in the event these representatives could not agree upon the budgets or upon general operating policy, the approval of International was *necessary* before Meneg could approve or make expenditures in relation to "major projects." Such projects were defined as including "geophysical work, permanent camps, hospitals, recreation buildings, water and light systems, pipelines, terminals, tank farms, and permanent facilities involving large expenditures." A disagreement between the parties did not bar Meneg from adopting that part of the budget "which covers expenditures on such matters as geological work (including test wells in connection therewith), drilling and completion of wells and the production of oil therefrom, the erection of field working tankage, construction and location of gathering lines, location and construction and moving of temporary field camps or any other usual operating matter relating to the reasonable and normal development of the property and the production of oil therefrom."

It was agreed finally that "Meneg shall have the control of the actual operations in connection with the properties and concessions held by it," including the pooled concessions, but that these operations were to be governed by the budgets and general operating policies as agreed on above.[64]

To sum up, International would not participate directly in Meneg's operation of the wholly owned properties or in the joint operation of the pooled concessions, but, rather, would have a supervisory control over all of these activities. International had an absolute power of veto over "major projects", i. e., the exploration, development, and permanent establishment of new crude-oil productive capacity and facilities. This restriction has considerable meaning in view of the intensive program of exploration and development then being carried on by Meneg and SOV in eastern Venezuela. The activities over which Meneg retained final authority relate to the further development of established oil-field projects and the maintenance of the production of crude oil therefrom;[65] i. e., Meneg's properties in the jointly owned oil fields of Lake Maracaibo.

[62] As part consideration for the agreement, International agreed to pay 50 percent of these expenditures. (See p. 176.)

[63] Art. 12. It was further provided in the Supplementary Agreement dated January 29, 1938, that the form of budget to be developed and adopted was to be one mutually agreed upon [art. III (13)].

[64] Art. 12.

[65] This interpretation flows from the specific detailed provisions cited in the text; e. g., the veto power over geophysical work suggests that the permitted geological work and drilling of wells relate to exploitation rather than exploration of properties. The context of the sentences in which these terms appear further emphasizes the limitations on Meneg.

Through these powers of International over Meneg's operations and through the participation of SOV in the pooled concessions, Standard (New Jersey) thus obtained substantial control over Meneg's business, and the Gulf Oil Corp. became a junior partner in the Venezuelan crude-oil production business.

It will be noted that the sale of physical property to International included the sale of one-half the book value of "surface leases" and, in fact, of "all property of every character." The terms relating to the sale of oil and of physical assets are so broadly written as to include all of the rights, benefits, burdens, and obligations commonly recognized as appertaining to ownership. In addition, a number of provisions were included in the agreement restricting and delimiting in detail Meneg's power to sell or transfer, to surrender, and to acquire concessions and interests in concessions.[66] Meneg agreed to notify International promptly of the details of any contemplated sale or transfer of concessions, including the name of the proposed purchaser and the price or consideration to be received by Meneg. International then had 30 days in which to decide whether or not it would take the property itself.[67] Meneg's freedom to surrender concessions or interests in concessions was similarly circumscribed.[68]

Finally, International was given the option of taking an undivided one-half interest in any new concessions or interests in concessions acquired by Meneg after December 15, 1937.[69] International agreed to pay one-half the costs of such acquisitions in which it elected to participate. Meneg was to hold the title of these joint properties.

The effect of all these provisions was to strip Meneg of any independent powers insofar as concessions were concerned. In the case of the "pooled concessions," Standard (New Jersey) now had control, through its subsidiaries, of both partners in the joint enterprise. The provisions of the principal agreement, taken together with those of the Meneg-SOV agreement, required that all "pooled concessions" be retained in the joint enterprise, or that they be sold or transferred wholly to the two Standard (New Jersey) subsidiaries except where their consent was granted for other disposition.

In the case of Meneg's wholly owned concessions, International—i. e., Standard (New Jersey)—had an unlimited option to buy or acquire any or all concessions which Meneg desired to sell or surrender, and an unlimited option to buy a 50-percent undivided interest in any or all concessions which Meneg purchased, provided it paid half the costs of acquisition. Thus, Meneg had traded away, in effect, nearly all of its rights to deal in concessions.

The quid pro quo.—The consideration paid by International to Meneg for one-half of Meneg's physical properties, future crude-oil

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[66] The intention of the parties was to maintain the titles to Meneg's concessions and interests in concessions clear and unencumbered, except insofar as the agreement with SOV applied (art. 1). Meneg was to do everything necessary to maintain the life of the concessions and to cure defects in their titles, International to pay one-half of those costs arising thereto allocable to future production of oil (arts. 1 and 2).

[67] Art. I. If the sale or transfer was intended by Meneg to leave undisturbed International's rights and obligations, International could itself buy the concession or the interest in the concession at the total price stated in the notice, or it could consent to the sale at that price. If the sale or transfer was intended by Meneg to have included and carried with it International's rights, International could itself purchase the concession or the interest in a concession at one-half of the purchase price stated in the notice, or it could consent to the transaction, receiving one-half of the purchase price or consideration.

[68] Art. 2. If International so elected, the concession or interest would be transferred to International, Meneg to receive no consideration for the transfer. If such a transfer could not be made for any reason, Meneg was required to operate the concession for International at International's cost and risk. If International did not elect to take the concession, Meneg was free to surrender it, except insofar as agreements with third parties (e. g., SOV) applied.

[69] Art. 6.

production, and other rights and benefits in Meneg's concessions and interests consisted of (*a*) the assumption of one-half of Meneg's burdens and obligations allocable to crude-oil production and (*b*) large nonrecurring cash payments.

As part consideration for the sale and transfer of Meneg's physical assets and the rights to share in all future rights from these properties as well as those jointly acquired under the agreement, International agreed "to reimburse Meneg for one-half of Meneg's net expenditures for current obligations accruing after December 15, 1937." "Current obligations" were defined as including all those "incurred in exploring and exploiting the said concessions, including administration expenses, and any joint handling and joint transportation within Venezuela of the oil produced therefrom." [70] Reimbursement in United States currency was to be made monthly in the case of current obligations, and "promptly" as other special expenses were incurred.[71]

International also agreed to pay Meneg $100,000,000 in cash as part consideration under the agreement. Of this, $25,000,000 was designated as "part consideration for (the) sale of oil," to be paid at the rate of 7 cents per barrel of total crude oil produced or acquired by Meneg for the joint account of itself and International. The total sum was to be paid as some 357,143,000 barrels of oil were produced or acquired within 8 years from December 15, 1937, whether or not such production were actually achieved within that period.[72]

In a separate agreement, International agreed to pay to Meneg a further sum of $25,000,000 on the date the principal agreement was signed, December 15, 1937, and additional sums of $25,000,000 each on December 15 of 1938 and 1939.[73] This total sum of $75,000,000, together with the agreements to pay one-half of all current obligations and $25,000,000 currently with oil production during a maximum period of 8 years, all in United States currency, constitute the "good and valuable consideration" paid to Meneg by International.[74]

The transaction, therefore, may be summarized as follows: [75]

1. Meneg sold and International purchased an undivided one-half interest in all of Meneg's physical properties. The net book value of this sale was fixed by Gulf at $9,781,426.

2. Meneg sold and International purchased rights to acquire at cost an undivided one-half interest in all future production of oil from Meneg's properties, and, also, rights to acquire at cost an undivided one-half interest in all properties acquired in the future by Meneg and in the production therefrom. Gulf fixed the money value of this transfer at $90,218,574.

3. International paid Meneg $100,000,000 and agreed to pay one-half of Meneg's future "current obligations," i. e., it agreed to pay the actual costs of its acquisitions as listed under item 2.

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[70] Art. 4.

[71] International also agreed to pay one-half of those costs incurred in curing defects in the titles of Meneg's concessions and interests in concessions and which were allocable to future oil production (art. 2), and one-half of the costs of acquiring those new concessions and interests in which International elects to participate (art. 6). All costs and burdens allocable to Meneg's sole interests or to crude-oil production before December 15, 1937, were carefully excluded from the burden assumed by International (art. 7).

[72] Art. 9. This assumes that Meneg's production quotas under the ratio agreement would be fulfilled. (See table 12, p. 184.)

[73] Letter agreement between Mene Grande Oil Co., C. A., and International Petroleum Co., Ltd., dated December 15, 1937.

[74] Insofar as the Commission has knowledge.

[75] This treatment is suggested by the explanatory notes in Gulf's consolidated balnce sheet as published in Moody's Industrials, 1950.

The principal effect of the transaction was a broadening and elaboration of Jersey Standard's controls over another sector of the world's petroleum resources. After the three agreements of December 15, 1937, of which two have been discussed thus far, only Jersey Standard and Shell remained as dominant members of the Venezuelan petroleum industry, Gulf having virtually disappeared as an independent factor.

A number of intangible values also changed hands, values that can be only imperfectly represented on a balance sheet. One such value has already been mentioned, i. e., the sale of future benefits in the concessions—the rights to future crude oil production. Obviously, it was impossible to determine, in 1937, the value of these rights and claims to future production. This sale included rights not only to one-half of the production from Gulf's proven and rich resources in the Lake Maracaibo region, but also a claim to one-half the oil to be produced from Meneg's holdings and interests in eastern Venezuela. That these holdings were regarded as extremely valuable is indicated by the fact that within a few months a 100-mile 16-inch pipeline from the Oficina oil fields to a new ocean shipping terminal was under construction.[76]

The intangible values arising out of this transaction, furthermore, extend to the broad international interests of Jersey Standard and Gulf. This is partly indicated by the close relationships that developed between them in the production of oil in Venezuela as a result of the three agreements of December 15, 1937. Under the principal agreement, Gulf transferred valuable properties, rights, and intangible values to Jersey Standard for a consideration of $100,000,000. Under the Meneg-SOV and principal agreements, the Venezuelan holdings of Gulf were brought into a partnership arrangement with Jersey Standard, the latter being the dominant partner. Under the ratio agreement, described below, the production of the two companies was to be regulated in accordance with their estimates of world market conditions.

The de facto merging of the interests of Jersey Standard and Gulf in Venezuela—an important source of supply for both of them—must inevitably have had a restricting or limiting effect on the rivalry of the two companies in the markets supplied from this source, such as the heavy fuel oil market in the United States and the markets for petroleum products in western Europe. The two companies had already been associated for some time in the foreign marketing cartels and cartel arrangements described in chapters VIII and IX. Under these arrangements, Gulf held an assured position in various markets in which it had held interests. These cartel relationships could not help but be strongly fortified by the close interweaving of the interests of Jersey Standard and Gulf in Venezuela. The larger interests of the two parties in cartel controls and profits, therefore, were undoubtedly furthered by their agreement to control and to share production in Venezuela.

The International-NOM main agreement.—About a year after the conclusion of the Meneg-International agreement, International sold a one-half interest in that agreement to a Royal Dutch-Shell subsid-

[76] The Oil Weekly, October 24, 1938, p. 47; and November 7, 1938, p. 23. A productive capacity of less than 10,000 barrels daily was established at the time construction began. The capacity of the pipeline was to be 75,000 to 100,000 barrels daily. Other large installations were likewise already under construction.

iary, N. V. Nederlandsche Olie Maatschappij (NOM). This agreement, known among the parties as the main agreement, was signed in Hudson County, N. J., on November 30, 1938, but was made retroactive to December 15, 1937. Substantially the main agreement brought Shell, through NOM, into the principal agreement as a full and equal partner with Standard, through International.

Upon being formally notified of the conclusions of the main agreement, Meneg apparently reserved its rights,[77] but later recognized the right of International to assign to NOM a one-half interest in the rights and burdens of International under the principal agreement,[78] thereby agreeing to the participation by Shell in the exercise of Jersey Standard's veto power. Each of the three parties thereupon agreed that [79] "it would not make *any assignment*, in whole or in part, of its respective interest" under either the principal or the main agreement, "*except with the consent* of the other parties hereto." [80]

Participation in the joint enterprise—Sale of oil and properties: The main agreement made NOM a full and equal partner with International, as of December 15, 1937, in each and every part of the principal agreement. Thus, it was provided that NOM would take delivery of one-half of all the oil delivered to International by Meneg under the principal agreement, a special allotment being given NOM to equalize the receipts of Meneg crude oil by the two parties from December 16, 1937.[81] International agreed to hold, for the joint account of itself and NOM, all property accruing to International under the principal agreement, until such time as Meneg would agree to vest in NOM an undivided one-half interest in said property, i. e., an undivided one-fourth interest in the whole enterprise.[82] International and NOM agreed to confer on each option received by International with regard to the acquisition of Meneg's interest in the sale, transfer, or surrendering of concessions, or interests in concessions. They also agreed to confer with regard to the purchase of an undivided one-half interest in new concessions or interests in concessions acquired by Meneg. The two parties would exercise the option jointly, or if only one party wished to participate, International would act either on its own or on NOM's behalf. Both would share in the proceeds received by International from the sale of any concession or interests by Meneg.[83]

In general, NOM was also to share in International's right to supervise Meneg's operations, but NOM was to act through International rather than directly. Thus, it was agreed that International would have the management of the personnel and the organization necessary in connection with Meneg's administration and management of the joint enterprise. International would also have charge

[77] Letter to NOM and International, dated December 19, 1938, contents not available to the Commission.

[78] Agreement between Meneg, International, and NOM, dated January 28, 1939, art. I. It was further agreed that NOM would receive its bills and make payments directly to Meneg for all its obligations under the agreements.

[79] Ibid., art. 4. (Italics added.) Such consent was not required where certain concessions acquired after December 15, 1937 (under B/L agreement of November 3, 1933, contents not in Commission's hands) are disposed of by any party to these agreements to any other such party or to SOV (agreement between Meneg, International and SOV, dated February 10, 1939). Interpretation of this and other clauses of the agreement depend on an agreement between Meneg and SOV of even date, which is not in possession of the Commission.

[80] This restriction did not apply to the sale or disposition of crude oil accruing to the parties under the agreement.

[81] Main agreement, art. 3, secs. (a) through (f). NOM was to take all of such deliveries by Meneg to International until it had assumed ownership of a total amount of oil equal to one-half the oil which had accrued to International from December 16, 1937, to November 30, 1938.

[82] Art. 3 (h).

[83] Art. 3 (g).

and control of all dealings with Meneg under the principal agreement.[84] International was obliged, upon request by NOM, to inspect properties and records covered by or subject to inspection under the principal agreement, and to report fully thereon,[85] or to institute and maintain arbitration proceedings.[86] Both parties mutually agreed to make available, to each other all geological, title, and other information relating to matters under the agreements and in their possession.[87] International granted full access to its books of account relating to all operations under the principal agreement.[88]

With regard to budgets, it was agreed that International and NOM would confer with regard to the budgets of capital and operating expenditures and the statements of general operating policy to be submitted to International by Meneg. International, however, was to have the ultimate authority in the event that these discussions were protracted or that agreement could not be attained.[89] Thus, disagreements were to be referred to the president of the Standard Oil Co. (New Jersey) and a managing director of either parent company of Royal Dutch-Shell;[90] but, if these referees could not resolve the questions at issue, "*the decision of International shall control.*" Similarly, International reserved its sole freedom of action in all cases where consultations or decisions were not concluded or rendered prior to December 15 of the year in which the budgets were submitted.[91] Thus, the veto power of International over the exploration and development by Meneg of new oil fields or of permanent expansions in capacity was opened to NOM, but the final voice was reserved to International.[92]

The quid pro quo

The main agreement made NOM an equal partner with International not only in the rights and benefits accruing to International under the principal agreement but also in the burdens and obligations thereby incurred and assumed by International. In substance, International transferred to NOM *at cost* a one-half interest in the principal agreement, constituting, in effect, an undivided one-fourth interest in Meneg. For this, NOM agreed to pay to International $50,000,000 plus one-half of all "current expenditures" charged to International by Meneg (i. e., one-fourth of Meneg's total costs of crude-oil production), beginning as of December 15, 1937, and con-

[84] Art. 5.
[85] Arts. 10 and 11.
[86] Art. 6.
[87] Art. 9.
[88] Art. 12.
[89] Art. 7.
[90] I. e., The Shell Transport & Trading Co., Ltd., (Great Britain) or the N. V. Koninklijke Nederlandsche Maatschappij tot Exploitatie van Petroleumbronnen in Nederlandsche-Indie (Netherlands).
[91] Art. 7. These budgets and operating statements were to be submitted by Meneg on or before November 1 of each year. (Italics added.)
[92] The main agreement also included the following miscellaneous provisions: The life of the agreement was to be that of the principal agreement and of any extensions thereof (art. 25). International agreed that it would not give its consent to any modification of or addition to the principal agreement or to any dealings by Meneg with any concessions, rights, or properties covered by that agreement, except those dealings expressly permitted, without the written consent of NOM, thus giving NOM a veto power over such changes or dealings qualified only by NOM's agreement not to withhold its consent unreasonably" (art. 17).

Elaborate provisions defining the rights of the parties in the event either party defaults in its obligations were also included, it being provided that, unless such defaults were made good within a year, all rights and obligations under the principal agreement would pass to the nonfaulting party (art. 16).

The performance by NOM of all its obligations under the main agreement was guaranteed unconditionally by its parent corporation, the Bavarian Petroleum Co., a principal subsidiary of Royal Dutch-Shell. Agreement between International Petroleum Co. and N. V. de Bataafsche Petroleum Maatschappij, dated November 30, 1938 (art. 2).

tinuing for the life of the agreements.[93] For these payments, NOM received (*a*) an undivided one-fourth interest in all of Meneg's then-owned physical properties, concessions, interests in concessions, and other assets, plus a one-fourth share in Meneg's crude-oil production from December 15, 1937, to the date of the agreement. NOM also acquired (*b*) the right to participate to the extent of an undivided one-fourth interest in all of Meneg's future growth, including all future acquisitions by Meneg of properties, concessions, and other assets, and all of Meneg's future oil production.[94] NOM's status as a partner with International under the principal agreement was further spelled out in the acquisition by NOM of the right to participate in the supervision and general management of Meneg's operations.

The main agreement was of great value to Shell for much the same reasons that the principal agreement was of great value to Standard (New Jersey).[95] Shell thereby gained an important voice and share in the exploration, development, and production of crude oil in the new fields of eastern Venezuela, where it had previously held no important interests. Shell acquired a share of the jointly controlled oil fields of Standard and Gulf in eastern Venezuela. Moreover, the joint control of the three companies in the Lake Maracaibo properties was more closely integrated. This partnership in oil properties, some of which were of enormous potential value, was made available to Shell by Standard at cost. The broad international interests of Shell and Standard, as well as Gulf, were reflected in the agreements. Shell was a participant with Standard and Gulf in the international cartels and cartel arrangements described in chapters VIII and IX. In view of Shell's strong interests in these international cartels and its large share of the international oil business, it was to the advantage of all three parties to bring Shell into these agreements for sharing and controlling Venezuelan crude-oil production. The interweaving of interests in Venezuela tended to result in the strengthening of the world-wide cartel relationships of the three companies. Gulf, internationally a less important company than Standard and Shell, became, by virtue of these agreements, a junior partner in the Venezuelan petroleum industry.

Production quota agreements

On the same dates that these agreements were signed, the various parties concluded other agreements which have never been made

[93] NOM's payments to International included the following: Payment of one-half of *all* of International's obligations under the principal agreement as follows: (1) prompt reimbursement of one-half of all payments, expenditures, and advances made to Meneg up to and including November 30, 1938; (2) prompt payment of one-half of the monthly bills for "current expenditures" as these became due; (3) prompt payment of one-half of all other obligations of International as these became due. The word "all" is italicized to emphasize that NOM obligated itself in specific terms to pay one-half of (1) all "current obligations" incurred after December 15, 1937, of (2) the $25,000,000 sums due on December 15, 1937, 1938, and 1939, of (3) the specified $25,000,000 consideration for the sale of oil, and of (4) all other "current and special obligations" arising from the operations of Meneg. These obligations appear to be a specific quid pro quo, an agreement by NOM to pay one-half of all International's obligations under the principal agreement in purchase of a one-half interest in all the benefits flowing to International under that agreement.

All of the additional costs of management and administration flowing from the main agreement were to be paid in equal shares by International and NOM (art. 14). All of these payments were to be made in United States currency unless otherwise specified by International (art. 4).

[94] With respect to concessions acquired by Meneg after November 30, 1938, NOM's rights to an undivided one-fourth interest were stated in terms of an option which NOM could exercise or not as it chose. (See p. 179.)

[95] Another important factor from Shell's point of view was the importance of this new eastern Venezuelan oil supply as a compensating resource to replace that lost in Mexico in March 1938 when the foreign oil companies were expropriated. Shell's production in Mexico in 1937 was about 15.6 percent of its total world output (outside of the United States, i. e., its production available for refining and sale in world markets). This was about 62 percent of total Mexican production (The Petroleum Times, June 4, 1938, pp. 729, 731).

public. These latter agreements established annually the total allowable production of Meneg and Jersey Standard's Venezuelan subsidiaries, and fixed for each a ratio or constant proportion of the total production. When considered in relation with the other agreements described above, the language of these quota agreements suggests that the various moves by Standard and Shell in Venezuela were designed to restrict production in that country in accordance with their estimates of world market conditions.

The four-party ratio agreement.—By far the most important quota agreement is that signed on December 15, 1937, at Toronto, Canada, known among the parties as the ratio agreement. The principal parties to this agreement were Meneg and two Venezuelan subsidiaries of Jersey Standard which were collectively referred to in the agreement as "Lagosov." These two subsidiaries were the Standard Oil Co. of Venezuela (SOV), which operated chiefly in eastern Venezuela and which signed the Meneg-SOV agreement, and the Lago Petroleum Co. (Lago), which operated on the Lake Maracaibo region in close cooperation with Gulf and Shell.[96] These two companies together represented substantially all of Standard's Venezuelan crude-oil-producing interests, except those acquired through International in Meneg, and accounted for about 50 percent of Venezuelan production.[97] The International Petroleum Co. also participated in the agreement by virtue of the Meneg-International principal agreement which represented the consideration exchanged between the parties for the ratio agreement.[98]

The ratio agreement fixed production quotas for Meneg and Lagosov for a period of 12 years and provided machinery for setting new quotas annually in 1950 and thereafter.[99] These production quotas were prescribed in accordance with certain "principles" and goals which are stated so broadly, however, that the agreement could only have been a partial instrument in their achievement.

Principles and goals. A formal statement was given of the basic considerations underlying the ratio agreement. This statement of guiding principles and ultimate goals sheds a considerable degree of light on the underlying motivations of Standard in Venezuela.

Meneg and Lagosov state at the outset that they are interested in producing, during the life of their concessions in Venezuela, the "total recoverable oil" therein. However, they are agreed that their desire—

> of advancing the exploration and development of their concessions * * * and of increasing the production therefrom * * * should be done in *an orderly manner* and in accordance with *good business and true conservation practices.*

Accordingly, the accompanying production schedules (discussed below) were prepared and are said to reflect the "estimates" of the two parties of the increases in production that can be made over the next 12 years.[1] In short, Standard, through Lagosov, and in partnership with Gulf in Meneg, fixed the total maximum production allowable in Venezuela under their mutual estimates of future world markets and agreed upon the respective proportions to be produced

[96] See p. 167.
[97] See p. 167.
[98] Preamble. This provision underscores the contention that all the agreements discussed in this chapter are to be read and interpreted together as one unified over-all agreement.
[99] The agreement was canceled in 1943, and, therefore, the provisions relating to the period beginning in 1950 apparently never came into effect. See below, p. 189 ff.
[1] Preamble. [Italics added.]

by Meneg and by Lagosov. No explanation was provided as to what logical or necessary relation these estimates (an economic determination) have to "true conservation practices" (an engineering or geological determination).

Lagosov was given the power of unilaterally increasing, but not decreasing, the respective quotas of the two parties during the initial 12-year period, under certain specified conditions. This power was granted to Lagosov, but not to Meneg, in recognition of the former's "more advanced development and its large and diversified available markets and connections," making it able to "better judge" the conditions permitting such increases.[2] This language suggests that Lagosov (i. e. Standard (New Jersey)) was recognized as the dominant party in fixing and adjusting the quotas for at least 12 years. This superior position flowed from Lagosov's dominant position in the Venezuelan petroleum industry and its much greater size than Meneg.[3]

While the above principles were set forth to guide the fixing of the production schedules up to and including 1949, a broader statement of principles and goals, including all the above principles as a starting point, was elaborated to guide the fixing of quotas for 1950 and after.

It was contemplated that beginning in 1950 the parties would determine annually the total crude to be produced by them in Venezuela and the respective proportions to be produced by each. In fixing these amounts, the parties would "take into account, to the extent that it is in the control of Meneg and Lagosov," the following ends that the quotas "should" be designed to promote: (1) the maintenance of total Venezeulan oil production at "*a fair ratio basis*" to that of world production outside of the United States; (2) the maintenance of "*a proper relationship*" of the production of Meneg and Lagosov to the total production of Venezuela; (3) the maintenance of "*a proper relationship*" of the production of Meneg and Lagosov to the total production of other petroleum companies in Venezuela.[4] The phrase "to the extent that it is in the control of Meneg and Lagosov" connotes something of an understatement, for these two, together with the Shell group, accounted for more than 99 percent of Venezuelan production in 1937 and 1938.[5]

Production quotas, 1938–49: The ratio agreement includes in its provisions "production schedules" or quotas for the 12-year period beginning in 1938. These schedules, prepared in accordance with the above-stated principles, reflect the estimates of the parties in December 1937 of the maximum production they could jointly produce and dispose of in world petroleum markets during this period "in an orderly manner," and it also fixed the proportions of the total to be produced

[2] Idem.

[3] See p. 167.

[4] Art 2. [Italics added.] The ratio between the two parties was to be fixed in 1950 and the subsequent years after considering (1) the respective crude-oil reserves; (2) the total recoverable oil during the life of the concessions; (3) other pertinent data.

[5] (See p. 167.) Gulf, Standard (New Jersey), and Shell, together with their world-wide affiliations and connections, were sensitive to and an important influence upon world markets outside of the United States. The three goals listed above, therefore, were reasonably attainable by the Gulf and Standard (New Jersey) subsidiaries in Venezuela, provided that an agreement or even a tacit understanding were arrived at with Shell.

Shell's operations in Venezuela were readily adaptable to such an understanding, for it had been Shell's practice for some time to assign fluctuating production quotas to some of its Venezuelan oil fields (but not to any of its Lake Maracaibo properties), which, as "reserve fields" took the impact of changes in Shell's world-wide demand. For example, the production at one of Shell's reserve fields was 1,200,000 barrels lower in 1937 than in 1936 because of a lower production quota assigned to it (The Oil Weekly, February 21, 1938, p. 54). Production on the Lake Maracaibo properties was, in large part, of an offset character, i. e., the three companies maintained their relative productions under cooperative working arrangements. (See p. 167.)

by each of the parties. The production schedules and the ratios or proportions are shown in table 12.[6] Meneg's quota included all oil accruing to International under the principal agreement.[7]

TABLE 12.—*Production schedules set forth in the ratio agreement and the ratios thereof*

[Average daily gross production [1] in barrels of 42 gallons]

Year	Production schedules			Ratios	
	Meneg [2]	Lagosov [3]	Total	Meneg [2]	Lagosov [3]
				Units	*Units*
1938	80,000	285,500	365,500	100	356.9
1939	100,000	345,000	445,000	100	345.0
1940	110,000	379,500	489,500	100	345.0
1941	121,000	417,450	538,450	100	345.0
1942	133,100	459,195	592,295	100	345.0
1943	146,400	505,114	651,514	100	345.0
1944	150,000	518,100	668,100	100	345.4
1945	150,000	518,100	668,100	100	345.4
1946	150,000	518,100	668,100	100	345.4
1947	150,000	518,100	668,100	100	345.4
1948	150,000	518,100	668,100	100	345.4
1949	150,000	518,100	668,100	100	345.4

[1] Defined in footnote 6, below.
[2] Mene Grande Oil Co.
[3] Lago Petroleum Corp. and Standard Oil Co. of Venezuela, jointly, including Venezuelan production of affiliated companies.

Source: Agreement between Mene Grande Oil Co., Lago Petroleum Corp., Standard Oil Co. of Venezuela, and International Petroleum Co., dated Dec. 15, 1937, art. I.

The total quota fixed for the two parties for 1938 was at the average rate of 365,500 barrels daily, while actual reported total Venezuelan average daily production was 515,500 barrels.[8] Thus, the agreed-upon productions schedules, if adhered to, would have amounted to about 70.9 percent of actual production. Meneg and Lagosov together produced a somewhat lesser proportion of 1938 production, however, and Shell subsidiaries produced somewhat more than the 29 percent of production left over for them in the ratio agreement.

It may be noted that the quotas gradually increased from 1938 through 1944 and were fixed at the 1944 level for the 6 years thereafter. The ratio of Meneg's production to Lagosov's was fixed throughout at approximately 100 to 345 units.[9] Provision was made, as described below, for possible increases, though not decreases, but the ratio relationship was to remain unchanged during the 12-year period.

Under the principal agreement, however, control of the oil was in somewhat different proportions than the production ratios. Meneg's

[6] The quotas are stated in terms of "gross production" which differed, in fact, only slightly from the "net-production" concept used in the Meneg-SOV and principal agreements. "Gross production," as defined in art. 7, means total production "from all sources," including all production from totally owned properties and the royalty oil payable in respect thereof, and including that portion of production to which a party is entitled from properties in which it has a part interest and all royalty oil applicable to such part interest. Royalty oil paid by one party to the other (e. g., that paid by Meneg to Creole, an affiliate of Lagosov and hence included with it, on its Lake Maracaibo properties) was included in the production of the party receiving the oil. "Net production" under the Meneg-SOV (p. 171, above) and principal (p. 173 above) agreements similarly included all oil produced, received, or acquired by the parties, but royalties paid in kind were deducted from the total. (Cash royalties were treated as a carrying charge.) Royalties in Venezuela have generally been paid in cash; in the postwar period, however, the Venezuelan Government has sometimes elected to take its royalties in kind.

[7] Art. 7. NOM's share of oil under the main agreement is taken from that deliverable to International under the principal agreement. The language of art. 7, cited in footnote 6, is sufficiently broad and inclusive so that the quota for Lagosov may be construed as including the production of properties operated by SOV subsidiaries and owned by North Venezuelan Petroleum Co. and the Pantepec Oil Co., etc.

[8] World Oil, July 15, 1950, p. 44.

[9] This stabilizes the relative production of the two parties at the actual 1937 ratio of production.

production quota was deliverable half to itself (i. e., to Gulf) and half to International. Of the total gross production allowed, therefore, Standard (New Jersey) would receive all of Lagosov's production (i. e., 345 units) and 50 percent of Meneg's (i. e., 50 units) while Gulf would receive only half of Meneg's production. Hence, on the basis of the production schedules, it was contemplated that through the 12-year period Gulf would receive 50 units as compared to 395 for Standard; i. e. a ratio of 100 to 790. The entry of Shell, through NOM, into the share arrangements with International would reduce Standard's share to 370 units, or a ratio of Gulf to Standard of 100 to 740.

Insufficient details of foreign operations of Gulf and Jersey Standard are available to determine whether the production and control ratios were adhered to after the agreement was concluded in December 1937 and up to the time it was canceled in 1943. For comparison with the ratio schedules, however, the division of production in 1947 among the major Venezuelan oil companies is shown here.[10] The respective proportions of Venezuelan production accounted for by Meneg, Lagosov (through its corporate successor, Creole), and Shell were as follows:

	Percent
Standard Oil Co. (New Jersey) (Creole Petroleum Corp.)	52.5
Shell group (3 subsidiaries)	27.7
Gulf Oil Corp. (Mene Grande Oil Co.)	14.6
Total	[1] 94.8

[1] *Survey of Current Petroleum Situation in Venezuela,* OIR Rept. No. 4796 (PV) Nov. 4, 1948, Department of State, Division of Research for American Republics, Office of Intelligence Research, unclassified. The remaining 5.2 percent of production was split up among a number of other companies the most important of which were the Texas Co. and Socony-Vacuum Oil Co.

Note that Shell's proportion of production in 1947, unlike Gulf's and Standard's, had fallen off significantly since 1937 (see p. 167). Whether this was due to temporary factors or represented a permanent decline is not known.

The actual ratios between Gulf and Standard (New Jersey) in 1947 appear to have been, for production, 100:360, and, for deliveries of oil, 100:770.

Only a negligible proportion of Meneg's and Lagosov's 1937 production came from oil fields in eastern Venezuela other than the long-established field at Quirequire; the newly discovered fields did not begin to yield commercially significant volumes of oil until 1940.[11] The production quotas, therefore, must be read with the following factors in mind:

(*a*) Nearly all of Meneg's and Lagosov's production in 1937 came from well-defined oil fields with established productive capacities.

(*b*) The limitations imposed by the quotas would be felt more severely in the new oil fields coming into production in eastern Venezuela—the source of Venezuela's lighter and higher-valued crudes.[12] A large proportion of Gulf's and Standard's potential capacity in eastern Venezuela was tied together in the "pooled concessions" so

[10] It should not be inferred that these data indicate the application of the restrictions of the ratio agreement in 1947.

[11] International Petroleum Trade, September 30, 1941, p. 258.

[12] The crude oils of eastern Venezuela were lighter than those of western Venezuela, and were more suitable for refining into higher-value products. These products were more competitive in nature with those refined from United States oils and sold in the domestic market or exported into world markets. Gulf and Standard (New Jersey) were keenly interested in both markets and may have wanted to create the machinery for control over eastern Venezuelan crude oil so as to be able to protect their interests. Shell's interest in such controls is obvious and is indicated in its adherence to the International-NOM ratio agreement discussed below.

that the quota restrictions, insofar as they had an unequal impact on one or the other, would operate uniformly in these new petroleum fields.

(*c*) The production quota system, together with the pooling of concessions and the management controls and restrictions on Meneg, were a potent instrument for controlling the development of eastern Venezuela or for the imposition, if need be, of restrictions or retardations on that development.

The production schedules discussed above were fixed at the same level from 1944 through 1949, suggesting that Meneg and Lagosov were unwilling to commit themselves to increases for more than a 6-year period. It was provided, however, that Lagosov, due to its superior position and knowledge,[13] could better judge what increases, if any, would be justified from time to time, as "marketing and other contemplated conditions permit." No provision was made for decreases in the quotas. Increases were to be instituted by unilateral action of Lagosov alone, that is, Lagosov could simply produce in excess of the quotas as it thought feasible.[14] Meneg, upon notification of this excess production could produce in the same year, or in the ensuing year, in excess of its quota an amount of oil equivalent to 100/345th of Lagosov's excess oil, thus preserving the ratio position of the parties.[15] The effect of these provisions was to give Jersey Standard, through Lagosov, a free hand in determining the production of itself and of Gulf in Venezuela, provided only that it could not fix that production at less than the quotas provided for in the agreement.

Quota machinery for 1950 and thereafter.—The ratio agreement provided a complete mechanism for determining production schedules after 1949. It was provided that on or before September 1, 1949, Meneg and Lagosov would each appoint one or more representatives to determine "the total crude oil to be produced by them from Venezuela for the year 1950 and the proportion to be produced by each".[16] The deliberations were to be guided by the principles and goals discussed above. This procedure was to be repeated annually. The agreement also set forth in some detail a voting procedure and provisions for resolving disagreements about the ratio to be established between the parties.[17] Moreover, it fixed the penalties to be imposed in cases of production in excess of the quotas.[18] Thus, the machinery was created for the fixing of production schedules over a period of many years in accordance with stated goals.[19]

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13 See p. 183.

14 Art. 1. During this initial 12-year period, however, Meneg was burdened with penalty clauses in the event that it produced oil in excess of its quotas except as permitted above. If excess oil were produced by Meneg, it was provided that one-half of such excess oil would be deliverable to International under the principal agreement and that Lagosov had the option of purchasing the other half of such oil at cost of production and transportation. Thus, Gulf stood to lose possession of all oil produced in excess of the quotas, that Lagosov had not authorized, while Lagosov retained complete freedom of action.

15 Idem.

16 Art. 2.

17 The combined representation of Meneg and Lagosov were each entitled to only one vote. International was authorized to have nonvoting representatives present. Should the parties fail to agree upon *the ratio*, it was agreed that the parties were to appoint a "third representative," i. e., an arbitrator, or, failing agreement on this third representative, application could be made by any of the parties to a judge of the Supreme Court of Ontario to appoint such third representative; the decision of the arbitrator was to be binding and conclusive upon the parties (art. 2). In no case, however, was the production schedule of Meneg to be fixed at less than an average gross production of 150,000 barrels daily (art. 3).

18 Penalty clauses for production in excess of quotas, beginning in 1950, were to be applied against both parties, but the incidence of the penalties was uneven. The provision for penalizing Meneg was repeated (see footnote 14, above); that is, half of the excess would be delivered to International, and Lagosov was given the option of purchasing the other half at cost of production, i. e., Standard (New Jersey) would get all the excess oil, Gulf nothing. Meneg similarly had an option to purchase *all* excess oil produced by Lagosov at cost of production, but half of the excess oil purchased must be delivered to International under the principal agreement, i. e., Standard (New Jersey) and Gulf would share excess oil on a 50–50 basis.

19 This agreement was canceled in 1943. Its stated life (art. 5) was the same as that of the principal agreement, i. e., the life of Meneg's concessions.

The saving clause.—A saving clause was included in the ratio agreement, designed, it may be assumed, to bring the agreement within the range of action permitted under the United States antitrust laws. However, the effect of the saving clause was qualified by an attached proviso which largely negated it. Article 4 of the ratio agreement states:

> Nothing in this agreement shall in any way restrict the right of any party hereto to increase production for import into the United States or reexport therefrom by itself or any third party; *Provided, however,* That such party will first apply its proportion of the amount of production to be produced by it pursuant to articles 1 and 2 hereof to its said requirements for import into the United States or reexport therefrom before the right to increase production specified in this article 4 is claimed or used.[20]

The first part of this article suggests that the ratio agreement was not intended to restrict the free flow of petroleum to the United States. But even without the attached proviso this provision had little meaning since imports into the United States were already subject to voluntary restrictions on the part of the oil importers,[21] limiting imports to 4.5 percent of American production, amounting to roughly 30 percent of Venezuela's production.[22] Under these conditions, any large increases in Venezuelan production, such as that expected in 1937 to result from the important new discoveries in eastern Venezuela, would be excluded from United States markets, except as increases in United States domestic production permitted increases in the import tonnage within the limits of the 4.5 percent voluntary restriction.

It may again be noted that this limitation of the United States market was itself an important consideration in the writing of the ratio agreement and the construction of regulating machinery. The agreement was designed to soften the impact of this new production, particularly from eastern Venezuela, not in the United States where it was effectively excluded but rather in the other natural markets for Venezuelan oil which were long-established and world-wide in scope.[23]

Whatever meaning was left to the saving clause was removed by the attached proviso. This proviso stated that a party wishing to exceed its quotas by shipment to the United States would first have to apply its full quota allowed for that year (i. e., "its proportion of the amount of production to be produced by it pursuant to articles

[20] Art. 1 is that in which production quotas were fixed for the 12-year period, 1938–49. Art. 2 provided machinery for fixing quotas for 1950 and after.

[21] Voluntary agreement with the Secretary of the Interior. See p. 169.

[22] In 1937, imports into the United States averaged about 143,600 barrels daily and totaled about 4.5 percent of domestic production. About 88 percent of these imports came directly from Venezuela as crude oil (39 percent) or indirectly from the Netherlands West Indies as heavy refined products (49 percent). About 45 percent of all petroleum imports were bonded for reexport. Foreign Commerce and Navigation of the United States in the Calendar Year 1937, p. 178. Venezuelan production in 1937 averaged about 510,000 barrels daily, and exports averaged a slightly lower figure. Thus in 1937 about 30 percent of Venezuelan production was imported directly or indirectly into the United States, much of this being bonded for reexport; about 70 percent was sold in other world markets.

[23] All three large Venezuelan producers had established markets outside of the United States. Shell and Standard (New Jersey) shipped most of their production to refineries in Netherlands West Indies and lesser amounts to refineries in Europe and the United States. The refined products manufactured at these places were sold in all world markets. International shipped its share of Mene oil to the refineries of its parent corporation, Imperial Oil Co., the Canadian subsidiary of Standard (New Jersey). Assuming that all of Standard's imports into the United States originated directly and indirectly from Venezuela, these imports amounted to about 35 percent of Standard's Venezuelan production. Gulf imported about half its production into the United States, where it was refined in Gulf's refineries, the products being sold domestically or bonded for export, and it presumably sold the other half of its production to others prior to the coming into effect of the principal agreement. Shell's imports into the United States at this time were a negligible proportion of its Venezuelan production. All these statements are based on data from Moody's Industrials, the Oil Weekly, November 13, 1939.

1 and 2 hereof") to its requirements for import into or for reexport from the United States, before it could claim or use the right to exceed its quotas for these purposes. In other words, if the quotas were to be exceeded under the saving clause, the total production would have to go to the United States and no other channels of distribution could be used.

This proviso effectively eliminated the possibility of quotas being exceeded in the case of shipments to the United States. For Meneg to use the saving clause, its part owners, International and NOM, would have to eliminate their normal channels of trade; similarly for Lagosov to use the clause, it would have to abandon the normal markets for a large proportion of its production.

The International-NOM ratio agreement.—At the same time that International and NOM concluded the main agreement, they signed a second document in which Shell, through NOM, recognized and assented to the ratio agreement. This recognition was required not only because NOM had acquired an interest in Meneg's production, but also because the budget provisions [24] of the principal agreement were to be "read in conjunction with and subject to the ratio agreement." [25] NOM, therefore, agreed that it would not use its voice, acquired in the main agreement, to disturb the arrangements made in the principal and ratio agreements regarding production.

It was agreed, however, that International would use "all reasonable endeavors to cause Meneg" to maintain its total production from all sources at the levels authorized by the production schedules under the ratio agreement, except where "contrary to good operating practice" or where the direct costs of the oil produced exceed its market value.[26] It was further agreed that the consent of NOM would be required for any change in the ratio agreement which would either release Meneg from the quotas, or which would require Meneg to produce less than the quotas.[27]

These provisions generally reflect the interests of Shell in receiving a stable and predictable supply of eastern Venezuelan crude from year to year.[28] They also reflect Shell's desire to maintain the quota system for Meneg and Lagosov, which together accounted for two-thirds or more of Venezuelan production. While Shell did not participate directly in the ratio and principal agreements, it had acquired through the main and the International-NOM ratio agreements an important voice and share in the arrangements included therein. Shell therefore had a direct knowledge and share in these arrangements. Moreover, since the greater part of Venezuelan production went to foreign markets, in most of which Shell was a principal supplier, it had a particular interest in their fulfillment. While Shell's own producing subsidiaries were not included in the quota schedules, it seems likely that their operations would have been guided by these considerations.[29]

Another agreement, which was extraneously included in the International-NOM Ratio Agreement, further cemented relations between

[24] See p. 176.
[25] Art. 5.
[26] Art. 1.
[27] Art. 6.
[28] This was important to Shell since this Venezuelan oil was to replace the petroleum resources owned by Shell and expropriated by the Mexican Government in March 1938.
[29] The International-NOM ratio agreement completed the process whereby Standard (New Jersey) and Shell had gained the dominant voice in the operations and management of Meneg, and Gulf had become, in effect, a junior partner.

Standard and Shell. International and NOM agreed that if either acquired, directly or indirectly, Gulf's holdings in Meneg, it would "*immediately offer one-half thereof to the other party at the cost to it of such one-half*".[30] Thus, the joint and essentially equal voice of International and NOM was to be maintained under all contingencies.

Cancellation of the four-party ratio agreement.—On January 13, 1943, representatives of the four corporations signing the ratio agreement executed a further agreement whereby the parties: (1) canceled the ratio agreement as of December 31, 1942, and (2) mutually waived and abandoned any claim of any nature arising out of that agreement. No reasons were given for this action and no provision was made for a superseding agreement. However, current circumstances and events, together with the fact that the provisions of the other agreements were still operative, help to explain this abrupt and laconic annulment.

In the first place, to achieve "economics in administration and operations," all of the Venezuelan interests of Standard (New Jersey), except those held by International in Meneg, were merged into the Creole Petroleum Co. during August and September 1943.[31] This change in Standard's corporate structure in no way directly affected the ratio agreement, but in the course of arranging the reorganization —which was bound to result in a certain amount of publicity— Standard may have felt that it would be better to have the ratio agreement out of the way.

More important was the impact of World War II upon current operations and prospective markets. Beginning in 1942, German submarine attacks on tankers substantially reduced the amount of Venezuelan oil shipments from the Caribbean area to consuming centers. The Venezuelan petroleum industry was thereby forced to curtail production from its peak production in 1941 of 625,800 barrels daily (average) to 404,600 barrels daily in 1942. As the submarine danger was brought under control, recovery was rapid. New tankers were built and production in 1944 averaged 704,200 barrels daily, with average daily production mounting rapidly thereafter.[32]

The agreed-upon production schedules and ratios, therefore, were inapplicable both to the lean years of 1942 and 1943 and to the fat years that immediately followed when the petroleum companies had every inducement to produce all the oil that could be transported. Further, the future became highly uncertain and unpredictable; what would world markets be like in the immediate postwar period? If the war should end before 1949, there would be no way of ascertaining whether the agreed-upon quotas and ratios would be applicable and "fair." Moreover, the machinery for fixing quotas beginning in 1950 might better suit the situation than that agreed upon for the period ending in 1949. All in all, it seemed that the safest course of action was to disregard a quota system that would be inoperative for an unpredictable number of years.

[30] These assets included "Any assets of Meneg [acquired] (otherwise than pursuant to the main agreement)", i. e., (1) any assets of Meneg owned and vested in Gulf as distinct from those owned and vested in International and NOM under the principal and main agreements, and (2) "any shares of stock, bonds, notes, debentures, or other securities of Meneg" (Art. 7 [italics added]).

[31] This reorganization was announced to the stockholders in March 1943. In it, SOV and Lago disappeared as separate entities in separate corporate hierarchies, and the control and administration of their properties and business was thereby considerably tightened. The status of the "pooled concessions" did not change; Creole merely supplanted its subsidiary, SOV, in the ownership and management relations with Meneg. In connection with this merger, Standard (New Jersey) later filed an application, dated May 5, 1944, with the New York Stock Exchange for an additional stock listing of 50,208 shares.

[32] All statistics from World Oil, July 15, 1950, p. 44. Production increased annually until 1948, when the daily average was 1,291,800 barrels, but it fell off slightly in 1949.

It may also be noted that the cancellation of the ratio agreement by no means ended all controls over the Venezuelan petroleum industry. The provisions in the principal and main agreements relating to annual budgets of capital and operating expense and to annual statements of operating policy insured strong supervisory controls over Meneg. Standard (New Jersey) and Shell still held, in 1947, direct and indirect control over 95 percent of all production in Venezuela.[33] The two companies conferred continuously and necessarily with respect to Meneg through their subsidiaries, International and NOM. The stability and solidity of even an implied or tacit understanding between them would be decisive in the control of Venezuelan oil.

Moreover, the International-NOM ratio agreement, so far as it is known, is still in existence,[34] though it is necessarily largely inoperative. It may be assumed that the written consent of NOM, which is mandatory, was freely given to the proposed cancellation of the ratio agreement and that Shell participated in that decision. The restriction upon the parties with respect to the acquisition of certain assets of Meneg is presumably still binding.

SUMMARY: THE SIGNIFICANCE OF THE AGREEMENTS

As of December 15, 1937, the Mene Grande Oil Co., a 100-percent subsidiary of the Gulf Oil Co., owned various oil concessions in Venezuela in its own right and owned interests in various other concessions jointly with others. It owned and held interests in the ownership of physical properties in connection with these concessions and concession interests. It held the right to develop and to participate in the development of them. It owned rights to future oil production from these concessions proportionate to its ownership. The net book value of these concessions, physical properties, and rights was $19,562,852.

On December 15, 1937, Meneg participated in a number of agreements with various Standard (New Jersey) subsidiaries. The net effect of these agreements and of subsequent agreements between the International Petroleum Co. and the NOM, a Shell subsidiary, may be summarized as follows:

(*a*) Meneg and SOV, a Standard (New Jersey) subsidiary, agreed, as of December 15, 1937, to "pool" all the concessions in which they had joint interests. These "pooled concessions" represented about 74 percent of all exploitation concession interests and about 90 percent of all exploration concession interests held by Meneg. Practically all of these were located in eastern Venezuela. While the concessions were to be "operated" by their legal owners the actual management and control over all exploration, development, and production was transferred to a committee representing equally the two partners. Additional concessions could be pooled at the discretion of and upon agreement of the committee. All costs of operation of each pooled concession were to be shared equally, and one-half of the oil produced on each pooled concession was deliverable to each of the parties. Thus, a large part of the properties of the two companies was, in fact, transferred from the separate management to that of a joint enterprise.

[33] See p. 185.
[34] Its life is the same as that of the main agreement, art. 8.

(*b*) Meneg sold an undivided one-half interest in all of its concessions, physical properties, and rights, as defined in the opening paragraph of this summary section to the International Petroleum Co., an indirect subsidiary of Standard (New Jersey), the sale taking effect on December 15, 1937. Included in this sale was an unlimited and continuous option to International to purchase all concessions and concession interests that Meneg might want to sell, transfer, or surrender, and a similar option to buy an undivided one-half interest in all new concessions and concession interests that Meneg might acquire. Included in the sale, also, was an undivided one-half interest in all physical properties of every description acquired by Meneg after the date of this sale. International later sold to a subsidiary of Royal Dutch-Shell, NOM, retroactively to December 15, 1937, an undivided one-half interest in all the concessions, properties, rights and options it had acquired from Meneg.

As of and after December 15, 1937, therefore, all of the assets, tangible and intangible, of Meneg were vested as follows: Gulf, 50 percent; Standard (New Jersey), 25 percent; Shell, 25 percent. Insofar as the "pooled concessions" were concerned, as distinct from all of Meneg's other assets, their ownership and all oil produced therefrom was divided as follows: Gulf, 25 percent; Standard (New Jersey), 62.5 percent; and Shell, 12.5 percent.

(*c*) Meneg surrendered valuable management prerogatives to its partners: (1) Meneg granted to International the right of access to and inspection of all of its properties, records, books of account, and all information, including geological, in its possession relating to its concessions and properties; (2) Meneg also agreed to submit annually budgets of capital and operating expense and statements of operating policy for all its properties and interests for the approval and concurrence of International, such approval being necessary for all exploration and development work other than that in connection with current and "normal" operation; (3) Meneg and Standard (New Jersey) operating subsidiaries agreed to fix total production schedules beginning in 1938, quotas being fixed under these schedules in the ratio, respectively, of 100:345. Machinery was provided for a revision of these production schedules and ratios beginning in 1950. The superior and dominating position of the Standard (New Jersey) subsidiaries was recognized by Meneg. These provisions were to be read and interpreted together with those relating to budgets and operating policy, i. e., Meneg's limited voice in the quota arrangement was subject to approval by International. While the quota arrangements were canceled in 1943, the budgeting arrangements are still in effect.

International admitted Shell, through NOM, to participation on a substantially equal basis in all the supervision rights it had acquired under the provisions summarized above. NOM thus acquired an equal right of access and of management through International. Similarly, it acquired knowledge of and approved and consented to the production quota arrangements. Meneg, in two separate documents,[35] recognized International's right to admit NOM to these arrangements and to the sale.

(*d*) In consideration of the sale and transfer of prerogatives as described above, International agreed to assume one-half of all of

[35] Both dated January 28, 1939.

Meneg's "current obligations" arising after December 15, 1937, or allocable to oil produced after that date, and to pay to Meneg $100,000,000. The consideration paid by NOM to International for one-half of International's acquisitions included the assumption by NOM of one-half of all of International's burdens, i. e., International transferred to NOM an undivided one-fourth interest in Meneg at the cost thereof to International. The net effect of the various considerations paid may be summarized as follows:

(1) The agreement by the parties to assume varying portions of "current obligations" represented, in effect, an agreement to pay all the costs of oil delivered and to be delivered to them after December 15, 1937. The payments were to be proportionate to the interest in the oil produced, i. e., Gulf, 50 percent; Standard (New Jersey), 25 percent; and Shell, 25 percent. The total amounts paid by the three parties from December 15, 1937, to October 31, 1947, a period of just under 10 years, were as follows:

Gulf (50 percent)	$172, 033, 708
Standard (New Jersey) (25 percent)	86, 016, 854
Shell (25 percent)	86, 016, 854
Total	344, 067, 416

Meneg's net production of oil during the same period was similarly divided:

	Barrels
Gulf (50 percent)	191, 073, 259
Standard (New Jersey) (25 percent)	95, 536, 630
Shell (25 percent)	95, 536, 630
Total	382, 146, 519

(2) As of December 15, 1937, the three parties had the following investments in Meneg's assets and rights: (*a*) Gulf owned an undivided one-half interest in the enterprise (net book value $9,781,426) and had a net "profit" on the sale of the other half of $90,218,574, i. e., it held its one-half interest free of cost, plus cash in hand or owed to it of $80,437,148. (*b*) Standard (New Jersey) owned an undivided one-fourth interest (net book value, $4,890,713) at a cost of $50,000,000. (*c*) Shell owned an undivided one-fourth interest (net book value, $4,890,713) at a cost of $50,000,000.

These investments were in addition to and separate from the burdens assumed and carried by the three parties for "current obligations," i. e., for the costs of producing oil after December 15, 1937. In accounting practice they represent charges paid for the rights to future production of oil from the concessions and properties owned by Meneg and the right to participate in such growth and expansion as Meneg might enjoy in the years to come.[36]

[36] Up to October 31, 1947, a total of 382,146,519 barrels of oil had been delivered to the parties under the agreement. Since the proven reserves of Meneg were estimated, as of January 1, 1948, in Gulf's Prospectus, dated January 27, 1948, page 3, at 575,000,000 barrels, this would suggest that the total resource made available to the partners was about 960,000,000 barrels. Standard and Shell had each purchased a one-fourth interest in this oil at a cost of $50,000,000, respectively. Gulf retained a one-half interest in the oil, and had a cash balance of $80,437,148.

The cost of the oil delivered to the parties during the life of these agreements can be calculated from this information. The cost of each barrel of oil acquired by Standard (New Jersey) and Shell is the actual cost of production, paid to Meneg as a "current obligation," plus 20⅚ cents. The cost to Gulf is the actual cost of production minus 16⅚ cents per barrel. With respect to Meneg's production, Gulf's advantage over Standard (New Jersey) and Shell is thus 37.6 cents per barrel.

Even if proven reserves double after January 1, 1948, this cost factor will continue to give to Gulf, over the entire life of the agreements, an advantage over Standard (New Jersey) and Shell of about 23.4 cents per barrel. Moreover, if Meneg's costs of production approximate those of Standard's and Shell's independent production in Venezuela, Gulf has had and will continue to have an over-all cost advantage for its share of Venezuelan crude.

The discussion in this footnote is suggested by the manner in which Gulf actually handled the transaction in its accounts, making its calculations, however, as of December 15, 1937. Moody's Industrials, 1950.

At the time the various agreements were signed, Standard and Shell were both much larger producers in Venezuela than Gulf. It was a time when the world petroleum industry was greatly concerned with the problem of "overcapacity"—a problem which could have been greatly aggravated by uncontrolled Venezuelan production. The interests of Standard and Shell lay in "stabilizing" and controlling Venezuelan production in relation to markets for petroleum and petroleum products elsewhere in the world. The various agreements described in these pages facilitated the achievement of this goal, and the exchange of money and rights to oil was the instrument for fixing the interests of the parties. For cash Gulf surrendered its management prerogatives and accepted a position as a junior partner in the Venezuelan industry. Standard (New Jersey) and Shell consolidated their control over the Venezuelan petroleum industry. Production quotas were fixed for about 70 percent of Venezuelan capacity. Shell alone remained outside of the quota arrangement but had knowledge of and consented to it.

These contracts for the sale of oil, therefore, had unusual features that distinguish them from ordinary business transactions. The three parties to the contracts became in reality partners in a joint enterprise, each holding undivided interests in the assets of the joint enterprise. The "price" paid by Jersey Standard and Shell for the oil they received was the cost of production of that oil. The "profit" accruing to Gulf for the "sale" of oil was the fixed sum initially paid, i. e., $100,000,000 less one-half of the book value of Meneg's assets in 1937, irrespective of the quantities of oil that would actually be delivered over the life of Meneg's concessions and interests in Venezuela. The "sale of oil" features of these contracts thus appear actually as a sharing of oil among the three companies, while the contracts themselves appear to have been designed to further the regulation and control of the development of crude-oil production in Venezuela.

PART III

PRODUCTION AND MARKETING AGREEMENTS

CHAPTER VIII

PRODUCTION AND MARKETING AGREEMENTS AMONG INTERNATIONAL OIL COMPANIES

BACKGROUND FOR INTERNATIONAL AGREEMENTS

In addition to (1) their outright ownership of reserves and production and distribution facilities, (2) their joint ownership arrangements, as in the Middle East, and (3) their agreements for the purchase and sale of crude, the leading oil companies have also exercised control over the industry through restrictive agreements regarding international production and marketing. These agreements, some of which are the subject of this chapter, constitute a series of steps by which the major international companies sought to establish more effective control over distribution and prices throughout the world.

A feeling that greater control in distribution markets was needed arose in the middle 1920's. At that time it became evident that the existing degree of control over production constituted an inadequate basis for controlling price competition, even among the largest companies; for a price war broke out in Asia between two of the large international interests, and thereafter, in 1928, an international cartel agreement was formed among the principal international companies. Its purpose was to forestall market competition, both among themselves and with others, through control of production and exports. But this agreement left largely uncontrolled the activities of important independent interests that were not parties to the agreement. It was followed by other agreements designed, first, to forestall competition more fully among the parties to the main agreement and, second, to extend the international groups' control over the activities of independents through separate local marketing agreements formulated, so far as possible, in accord with the principles and procedures agreed upon by the parties to the main agreement. These agreements covered the period from 1928 to the outbreak of World War II. They were an integral part of the pattern of concentrated big-company control over world oil resources and trade described in other chapters of this report.

Division of the Indian market

The price war which immediately preceded the first international agreement broke out in India in 1926. It was a striking illustration of how price competition between two of the big companies in one consuming area could spread to other markets and have a disastrous effect on the profits of all.

The concerns directly involved were Royal Dutch-Shell and Standard Oil Co. of New York. Royal Dutch-Shell owned some of the properties seized by the Russian Government in 1918. Nevertheless, both Shell and Standard of New York continued throughout the early 1920's to buy quantities of Russian crude oil which they refined

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and sold in India and other far-eastern markets. After several years of unsuccessful negotiation for compensation for its properties, during which new reserves and production were being developed elsewhere, Shell decided to retaliate against the Russian Government by buying no more Russian oil, and asked Standard of New York to do likewise. Shell had substantial production in Rumania which it could substitute for Russian oil, but Standard of New York had no substitute crude as favorably located with respect to the Indian market. Had Standard ceased buying from Russia, it would not only have thereby strengthened Shell's position in pressuring the Russians, but also would have weakened its own competitive position in India, and thereby practically imposed upon itself the necessity of acknowledging the market leadership of the British-Shell combine in India. Standard decided that, in order to remain in the Indian market, it would have to continue to buy Russian oil. Sir Henri Deterding, of Shell, said that he proposed to fight every effort of Standard to market Russian oil in India. Standard countered Deterding's opposition by alleging that Shell was seeking a monopoly of Russian oil.[1]

On September 19, 1927, Royal Dutch-Shell announced that the price of kerosene in India would be reduced immediately, should any more Russian oil arrive at Indian ports. But Standard was not deterred; and on September 23, 1927, price reductions were made. Further reductions followed,[2] developing into a price war in India between Standard of New York, and Shell. Steps were taken by each to broaden the conflict. Shell intensified competition in the United States, while Standard of New York intensified its advertising of ethyl fuel in England.[3] As the competition between the two companies spread, other world markets were involved and other international marketing companies found it necessary to reduce prices to hold their respective positions.

This intensive price competition, however, was short-lived. Late in 1928, an agreement was reached between Standard of New York, Shell, and Anglo-Persian which ended the struggle over the Indian market. Few details are available, but apparently an understanding was reached whereby the Indian market was divided between Standard, Shell and Anglo-Persian.[4]

Shell's action in carrying the price competition to the American market affected the operations of all American oil companies. On the other hand, the action of Standard of New York in staying in India notwithstanding low prices, and in intensifying the promotion of its ethyl gasoline in England, brought sharply to the attention of Anglo-Persian and Royal Dutch-Shell the possibility that Standard might increase its sales in Great Britain and continental Europe and that other American interests might take similar action. The relative positions of all international companies in the principal consuming markets of the world were jeopardized. Thus, the stage was set for an international live-and-let-live policy. This was the background against which the first steps toward cartel control of world markets were taken in 1928.

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[1] The Petroleum Times, London, January 28, 1928, p. 168 and February 4, 1928, p. 210.
[2] The Petroleum Times, London, January 28, 1928, p. 168.
[3] Ibid., March 3, 1928, p. 400.
[4] International Cartels, United Nations Secretariat, Department of Economic Affairs, 1947, table 1; see also Leith, Furness and Lewis, World Minerals and World Peace, The Brookings Institution, 1943, p. 113.

THE ACHNACARRY AGREEMENT

The rapidity with which the Indian price war had spread from India to American markets and then back to Europe made it apparent that control of reserves in newly discovered fields was not, in and of itself, an effective guaranty against the outbreak of competition.

With this experience fresh in mind, Royal Dutch-Shell, Anglo-Persian Oil Co., Ltd., and Standard Oil Co. (New Jersey) sponsored many conferences and meetings during the early months of 1928. It appears that American interests took the lead in attempting to formulate an international working agreement.[5]

Before any machinery for actual controls could be set up, a set of general principles and procedures had to be formulated which would be acceptable to practically all of the oil industry itself,[6] would avoid opposition by the various national governments involved,[7] and could be effectively applied to the differing conditions prevailing in particular producing areas and consuming markets.[8]

The burden of drafting such a document was undertaken by Walter C. Teagle, of Standard Oil Co. (New Jersey); Sir Henri W. A. Deterding, of Royal Dutch-Shell; and Sir John Cadman, of Anglo-Persian Oil Co., Ltd. The actual work appears to have been done in England.

How this document came to be known as the Achnacarry agreement was described in the trade press of the day, which quoted Mr. Teagle as having said: [9]

> Sir John Cadman, head of the Anglo Persian Oil Co. and myself were guests of Sir Henri Deterding and Lady Deterding at Achnacarry for the grouse shooting, and while the game was a primary object of the visit, the problem of the world's petroleum industry naturally came in for a great deal of discussion. * * * Any attempt at regulation of overproduction of crude would obviously require cooperation of a vastly greater number and diversity of interests than were represented at Achnacarry Castle.

The document finally adopted bears the simple title Pool Association and the date, September 17, 1928. It is more often referred to, however, as the "as is agreement of 1928" or the Achnacarry agreement. The document consists of three parts: a preliminary statement, a set of principles, and a combined declaration of "policy" and outline of procedure to be followed by participants in applying the principles.

The preliminary statement consists of a series of paragraphs justifying the proposed control measures. The nature and scope of this part of the document, which may be regarded as the industry's brief for controls, is indicated by the following key passages:

> Certain politicians, with the support of a portion of the press, have endeavored to create in the public mind the opinion that the petroleum industry operates

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[5] The Oil and Gas Journal, June 19, 1927, p. 38, stated: "Now that the differences of Royal Dutch-Shell and Standard of New York have been adjusted, the American companies have taken the lead in bringing about an international accord on the subject of oil conservation and supply."

[6] It is a cardinal fact of cartel economics that even a small "fringe" of uncontrolled production or market supply may disrupt the smooth operation of cartel controls by making them more beneficial to the fringe than to the participants.

[7] A plan to restrict production or divide markets which was fully sanctioned by law in some countries might be condemned by law in others.

[8] A plan suitable to control of production in Persia or the Dutch East Indies, where reserves and production were controlled by a few interests, might be unworkable in the United States where control of reserves and production was so diverse as to make concerted private control of reserves and production difficult, especially in view of the prohibition of the antitrusts acts. In refined products marketing, controls which were applicable in a market where there was no uncontrolled fringe of noncooperating suppliers might be unworkable in a market where even a small percentage of the total market supply was furnished by outsiders.

[9] The Oil and Gas Journal, September 20, 1928, p. 40.

solely under a policy of greed and has itself initiated methods of wanton extravagance. This contention is absolutely unjustified, ignoring as it does, the problem of the oil industry.

Since its inception, the oil industry has looked forward with apprehension to the gradual depletion and final exhaustion of its supplies of crude oil. The temporary shortage of supplies that existed in certain countries during the Great War further accentuated this fear and caused vast sums of good money to be expended to locate and develop reserves in all parts of the world where petroleum potentialities appeared, as well as in accumulating large reserve stocks above ground. Now the situation has changed. An adequate supply for a long time to come is assured * * *.

Excessive competition has resulted in the tremendous overproduction of today, when over the world the shut-in production amounts to approximately 60 percent of the production actually going into consumption.

* * * * * * *

Up to the present, each large unit has tried to take care of its own overproduction and tried to increase its sales at the expense of someone else. The effect has been destructive rather than constructive competition, resulting in much higher operating costs. * * *

The petroleum industry has not of late years earned a return on its investment sufficient to enable it to continue to carry in the future the burden and responsibilities placed upon it in the public's interest, and it would seem impossible that it can do so unless present conditions are changed. Recognizing this, economies must be effected, waste must be eliminated, the expensive duplication of facilities curtailed * * *.[10]

Governing principles

As a basis for accomplishing the desired objectives, the following seven principles to govern proposed group action were set out:

1. The acceptance by the units of their present volume of business and their proportion of any future increases in consumption.
2. As existing facilities are amply sufficient to meet the present consumption these should be made available to producers on terms which shall be based on the principle of paying for the use of these facilities an amount which shall be less than that which it would have cost such producer had he created these facilities for his exclusive use, but not less than demonstrated cost to the owner of the facilities.
3. Only such facilities to be added as are necessary to supply the public with its increased requirements of petroleum products in the most efficient manner. The procedure now prevailing of producers duplicating facilities to enable them to offer their own products regardless of the fact that such duplication is neither necessary to supply consumption nor creates an increase in consumption should be abandoned.
4. Production shall retain the advantage of its geographical situation, it being recognized that the value of the basic products of uniform specifications are the same at all points of origin or shipment and that this gives to each producing area an advantage in supplying consumption in the territory geographically tributary thereto, which should be retained by the production in that area.
5. With the object of securing maximum efficiency and economy in transportation, supplies shall be drawn from the nearest producing area.
6. To the extent that production is in excess of the consumption in its geographical area then such excess becomes surplus production which can only be dealt with in one of two ways; either the producer to shut in such surplus production or offer it at a price which will make it competitive with production from another geographical area.
7. The best interests of the public as well as the petroleum industry will be served through the discouragement of the adoption of any measures the effect of which would be to materially increase costs with consequent reduction in consumption.[11]

Principles 1 to 6, inclusive, cover points essential to a scheme of control through the pooling of industry resources. This was to be accomplished by (1) accepting and maintaining as their share of the

[10] Pool Association (Achnacarry) agreement of September 17, 1928.
[11] Ibid.

industry the status quo of each member; (2) making existing facilities available to competitors on a favorable basis, but at not less than actual cost to the owner of the facilities; (3) adding new facilities only as actually needed to supply increased requirements of consumers; (4) maintaining for each producing area the financial advantage of its geographical location; (5) drawing supplies from the nearest producing area; and (6) preventing any surplus production in a given geographical area from upsetting the price structure in any other area. Point 7 gives a consumer-interest turn to the purpose of accomplishing savings and stabilizing the industry.

Policy and procedural provisions

This part of the document covers nearly two-thirds of the 17 typewritten pages constituting the agreement. It consists of 2 introductory paragraphs and 15 numbered policy and procedural paragraphs. The two introductory paragraphs clearly state its general purpose:

> If these principles are followed, the result will be a stabilization of the world's market *outside of the United States domestic market* which will be in the interest of all.
>
> To give effect to the above it will be necessary for the groups to adopt a uniform policy, which in each country of production will have to be considered separately, based on the particular conditions existing in each such country. * * * [12]

The field of cartel action.—The first of the policy and procedural paragraphs said that the first step would be the adoption of [13]—

> An arrangement to cover all exports of petroleum and its products, with the exception of lubricating oils, paraffin wax, and specialty products, which shall be the subject of further consideration, *and excepting all exports made to the United States.*

Specific statements limiting the stabilization envisaged to the world "market" outside the United States, and limiting the agreement's operation to "all exports * * * excepting exports to the United States," obviously were intended to exempt the cartel from the United States antitrust laws by declaring both the domestic market and export trade of the United States to be economic and political areas not affected by the agreement.

Nevertheless, the agreement necessarily affected both imports into and exports from the United States. In regard to the former, the agreement contemplated that all "groups" operating in countries outside the United States would adhere to the agreement and be subject to principle I, covering "acceptance by the units of their present volume of business and their proportion of any future increase in consumption." Application of this "as is" principle to the production of American companies in foreign countries automatically limited the quantity of foreign oil which they might produce and thereby limited the amount they might ship to the United States.

In regard to the exports, machinery apparently designed to subject them to the principles of the Achnacarry agreement was established immediately. Two American export trade associations were set up within a few months after the Achnacarry agreement was formulated. The first was the Standard Oil Export Corp., formed in December 1928, with a membership consisting of Standard Oil Co. (New Jersey)

[12] Ibid. [Italics added.]
[13] Ibid. [Italics added.]

and five subsidiary companies. The second was the Export Petroleum Association, Inc., formed early in 1929 with a membership consisting of Standard Oil Export Corp., mentioned above, and 16 other American oil companies interested in exporting petroleum products. This latter body brought all of the most important American international oil companies under a single Webb-Pomerene export association. This association had the machinery to allocate among its members "as is" quotas similar to those of the Achnacarry agreement. Liaison was established between the Export Association and the Achnacarry cartel through Standard Oil (New Jersey), which was a participant in both organizations. As will appear below, some members of the association attempted to apply the Achnacarry principles to American export trade in spite of the formal exclusion of that trade which appears in the text of the Achnacarry agreement.[14]

Quotas.—Policy and procedural paragraphs 2 to 6, inclusive, dealt with the formulation of two types of quotas for the base period and subsequent years, and set forth general rules for operation thereunder. The two types of quotas covered, respectively, the performance of each group, first, in each country, and, second, in all countries combined. Since some groups might undersell in some countries and oversell in others, a method of adjusting and equalizing performance was necessary if the performance in later years was to be so adjusted as to maintain the proportions fixed by the base period quotas. The general rules for determining quotas and adjusting the performance of the groups in subsequent years were set out in procedural paragraph 2, as follows:

> 2. The proportion of the exports of each group to be ascertained on the following basis:
>
> (*a*) The quantities of each product the groups have delivered in each country during the period from _______________ to _______________ shall be added, and the proportion of each group's deliveries of the total shall be ascertained for each product and each country. The proportion of the total deliveries of each product so ascertained for each group shall be the quota each group shall be entitled to supply of the total imports of all groups in the country in question.
>
> (*b*) The percentage shall furthermore be ascertained which the total of each group's deliveries in all countries bears for each product to the total of all of the groups' deliveries.
>
> (*c*) If during any 1 year the total of all the quantities supplied by a group as under (*a*) is less than the quantity based on the group's percentage of the total supplies of all groups as under (*b*), then the group shall have the right to offer to the oversupplying groups the difference, and the oversupplying groups shall be obliged to purchase from the undersupplying group the quantity of a product so offered in proportion to their oversupply, at the Gulf price basis.[15]

Briefly, the paragraphs quoted above embody the basis for determining and maintaining the "as is" position of the participating groups, both in individual countries and in the world market as a whole. Compliance with the "as is" principle was to be attained by all participants agreeing that if they were oversuppliers they would purchase from those who were undersuppliers. An example was

[14] For further discussion of the organization and operation of the two American export associations, see p. 218 ff., below.

[15] Achnacarry agreement of September 17, 1928. The copy of the agreement from which the above par. 2 is quoted contains no definitely specified base period upon which quotas were to be determined; however the first of the seven principles quoted on p. 200, above, required "the acceptance by the units of their present volume of business." In accordance therewith the base period used from the outset appears to have been the 1928 calendar year. This was the base period definitely specified in a subsequent agreement entitled "Memorandum for European Markets," dated January 20, 1930, which was intended to implement some of the principles of the Achnacarry agreement. (See p. 230, below.)

worked out in detail to show how, under conditions of changing market demand and volume of business done by different groups, the over-all "as is" status of all suppliers during the base period would be projected into the future. Thus, the maintenance of the "as is" status was to be tied to and maintained by purchases and sales within the group. These cartel transactions would be made on the basis of prices at United States Gulf ports under a special cartel pricing system described below.

Procedural paragraphs 3, 4, and 5 dealt with three possible contingencies under which an undersupplying group [16] might not wish or might not be able to supply its full quota, and the procedure to be followed in filling these undersupplied quotas. Paragraph 3 provided that if any undersupplying group did not offer to sell to oversuppliers, its right thereafter to do so would be forfeited. Paragraph 4 dealt with the contingency of inability to supply for reasons beyond the control of the undersupplier. It provided that any group unable to supply its full quota by reason of force majeure, would forfeit its right to supply a quota proportion equal to the proportion of its undersupplies during the period of force majeure. It also provided that this forfeiture would continue after the force majeure ceased to exist for a period equal to the time during which the party was unable to supply. Finally, paragraph 5 dealt with the reallocation of the quota of an undersupplier who failed to supply its quotas under (*a*) of paragraph 2 for a period of 6 months for any reason other than force majeure. Such an undersupplier would forfeit its right to the extent that it undersupplied, and this part of its quota would be allotted to the other groups in proportion to their quotas.

Principle No. 4 was a declaration that production should retain the advantage of its geographical situation "it being recognized that the value of the basic products of uniform specifications are the same at all points of origin or shipment." This principle implies standardization of the basic products. Standardization of product of the type necessary to obtain this objective does not appear to have existed in the industry. To correct this, paragraph 6 provided that the groups were "to agree on a standardization of quality for the various products" with the added parenthetical note, "It will be necessary to work out detailed specifications therefor."

Pooling transportation facilities.—Policy and procedural paragraph 11 dealt with the transportation of products shipped under the export quotas set up under the agreement. Each individual group was to have the right to transport its assigned quota to each destination in its own vessels if it so desired. If, however, it was unable to transport in its own vessels, or elected not to do so, then the association was to assign tonnage. To provide a working pool of tonnage subject to the cartel's control, the participating groups agreed to:

> * * * offer to the association [the cartel's administrative agency] any surplus tonnage they may have before chartering the same to outsiders, and the association shall have the first call on such tonnage provided it is willing to pay rates for same not below those which the group or groups can obtain from others at the time.[17]

[16] "Group" was used in the agreement to designate a company or group of affiliated companies, such as Standard Oil Co. (New Jersey) and its subsidiaries and affiliates, all of which participated in the agreement as a group.

[17] Achnacarry agreement, procedural par. 11.

The cartel's administrative agency, on its part, was bound to:

> * * * charter from the other groups tonnage owned by them which they may offer to the association at freight rates at which the association is able to charter outside tonnage.[18]

Reciprocal exchange of supplies.—In addition to the establishment of a quota system for the division of markets on an "as is" basis and the creation of a transportation pool, the Achnacarry agreement also provided for a rather elaborate method of exchanging oil supplies among the various participants. The principal purposes of this exchange were to direct supplies to each market from "the nearest producing area," [19] thereby reducing transportation costs through the elimination of cross hauling, and to minimize the tedency to erect duplicate facilities. Avoidance of duplication was expected to result because the participants, in thus exchanging oil supplies, would tend thereby to share each other's existing facilities, [20] and would tend to limit the erection of new facilities to those "necessary to supply the public with its increased requirements of petroleum products in the most efficient manner." [21]

Method of effecting exchange of supplies.—The method of effecting the reciprocal exchange was designed as part of an over-all scheme for controlling the petroleum production of the participants to the agreement. The members agreed to make arrangements providing that each participant would "maintain it quota of deliveries irrespective of sources of supplies and obligate itself to purchase from the groups exclusively all of its imports of petroleum products that fall under the scope of the arrangement." [22] This provision eliminated all purchases of supplies from outsiders and made the cartel administrative agency the sole source of supply for its members. It was further agreed that the groups, acting through the administrative agency to be set up, would "direct shipments to the geographically most favorably situated area." [23]

This scheme to eliminate outside sources of supply and to route supplies economically within the cartel was fortified by two other provisions. The first was that participants would not sell to outsiders at prices more favorable than to cartel members.[24] The second envisaged the contingency that some participant might have a surplus over what it might supply under its quota, which it might wish to sell at prices lower than those posted by the cartel management. This possibility was covered by the provision that such a group:

> * * * shall offer same to the other groups at a price below that posted by the association for the product or products in question. Each of the groups shall then have the right to purchase the quantities so offered, in proportion to their quota and if one group declines to so purchase, and the other be willing to purchase then the willing group may purchase all of the quantities so offered. *The quantities so purchased shall be supplied by the purchasing group or groups under this agreement at the posted price against their quota.*[25]

Thus, surplus production was to be disposed of at low prices among the cartel members and under the cartel quota system, while sales regularly made to outside marketers by cartel members under their

[18] Achnacarry agreement, procedural par. 11.
[19] Ibid., principle No. 5.
[20] Ibid., principle No. 2.
[21] Ibid., principle No. 3.
[22] Ibid., procedural par. 8.
[23] Ibid., procedural par. 10.
[24] Ibid., procedural par. 8.
[25] Ibid., procedural par. 14. [Italics added.]

quotas were never to be made at prices lower than those charged in intracartel sales and reciprocal exchanges.

Intracartel pricing methods.—The pricing method adopted for intracartel sales and exchanges was designed both to reserve to the cartel members all cost savings resulting from the exchange of oil supplies and to give effect to principle No. 4 of the Achnacarry agreement, which declared "that the value of basic products of uniform specifications are the same at all points of origin or shipment."

The participants agreed that the cartel administrative agency would prepare—

> * * * for 6 months in advance, on the basis of current freight rates, statements of relative freight rates from each port of shipment to each port of import.[26]

These freight rate schedules were incorporated into the cartel pricing system as follows:

> Each group shall be paid f. o. b. port of shipment for each product on the basis of the Gulf price; or, if the goods are supplied c. i. f. port of import, the marketing organizations shall pay to each group this price plus the freight rates scheduled for the port of import under the statement prepared by the association. (NOTE.—The United States Gulf prices shall be the basis until further notice by the association.)[27]

The agreement on freight rates was designed to stabilize this important element of petroleum prices. In each case in which a sale or exchange of supplies was made and a transportation charge was involved, the transportation charge was to be fixed by a rate schedule, made after due consideration of "current freight rates." Once the cartel's relative freight rates were fixed, they could not change for 6 months, even though they ceased to reflect open market private charter rates. The observance of such arbitrary rates undoubtedly was facilitated by the fact that the participants owned outright, or controlled under long-term charters, the vessels in which their oil would normally be shipped. As stated above, the participants had also agreed to pool and place at the disposal of the cartel management any surplus tonnage which might arise.

Thus in each transaction among the cartel members in which a transportation charge was involved, a stabilized charge was to apply. Since oil supplies were to be directed to the "geographically most favorably situated area," the applicable charge in each case was to be the freight charge determined in advance from the nearest port of shipment. It was further agreed that, until further notice from the cartel administrative body, the United States Gulf prices would be the "base price" at every port of shipment.

The pricing method adopted for internal cartel use, therefore, provided for a uniform base price at every port of shipment plus an agreed freight rate in all applicable cases. This pricing method was to apply both to oil supplies exchanged so as to achieve economies for the benefit of the cartel members and to petroleum products sold among the cartel members in adjustment of over- and under-trading. Sales of surplus products among the cartel members, however, were to be made "at a price below that posted by the association for the product or products in question."[28]

Operation of the exchange and pricing system.—An example, bearing the same date as the Achnacarry agreement, was worked out by the negotiators of that agreement to show how the combination of the

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[26] Ibid., procedural par. 11.
[27] Ibid., procedural paragraph 13.
[28] Ibid., procedural par. 14.

cartel pricing method with the reciprocal exchange of supplies would work to the advantage of each of the participants. The example is as follows:

> Let us assume AP [Anglo-Persian] is entitled to supply 100,000 tons, and this quantity is shipped from Persia to Italy instead of from Persia to the AP's own marketing organization in Great Britain, this marketing organization receiving instead 100,000 tons from the Shell from the U. S. Then, assuming other figures, we would have the following picture:
>
> 1. AP's selling organization in Great Britain is supplied by the Shell with 100,000 tons from the U. S., paying therefor to Shell 10 cents per gallon and 20/-freight.
> 2. AP's selling organization realizes from the sale and delivery of these 100,000 tons a return of £150,000.
> 3. AP supplies to Italy 100,000 tons and receives therefor 10¢ per gallon and a freight rate of 18/– per ton.
>
> Then, AP has realized for its 100,000 tons of products a net return of £150,000, less local marketing expenses in Great Britain, less cost of Transportation from *U. S.* to Great Britain instead of realizing for this quantity £150,000 less the same marketing expenses and less cost of transportation from *Persia* to Great Britain. Consequently AP saves the difference in cost between transportation from *U. S.* to Great Britain as against Transportation from *Persia* to Great Britain.[29]
>
> The fact that AP's marketing organization may have paid to the Shell a higher freight rate for the transportation of the 100,000 tons from the U. S. to Great Britain than self cost does not in the least change this, since AP will receive for the transportation from Persia to Italy a proportionately equally higher freight rate. Whatever excess it may have paid over self cost through its British marketing organization for Atlantic maritime transportation to Great Britain will be returned to AP by the proportionately equally high excess over self cost AP will receive for the transportation from Persia to Italy. On the other hand, if the Shell sells through its Italian marketing organization the 100,000 tons of products supplied by AP to Italy then the Shell will realize for the 100,000 tons supplied to AP in Great Britain the Italian price less the freight from Persia to Italy instead of the Italian price less the freight from the United States to Italy, thereby making an additional profit by saving the difference in freight from Persia to Italy as against U. S. to Italy.

The balancing of freight savings as between the two points of origin and the two destinations would obviously be upset by any change in transportation rates. The stabilized schedules of freight rates, therefore, assured to each party that the freight savings resulting from the reciprocal exchange of supplies would be equitably divided between them. Furthermore, the use of a common base price (United States Gulf price), irrespective of the source of supply, assured to each participant uniform base prices for its petroleum products at each port of shipment irrespective of its costs of production.

Cartel versus world pricing methods.—The way in which the freight savings to be achieved by the reciprocal exchange of supplies would be reserved entirely for the benefit of the cartel members becomes clear in a comparison of cartel pricing with world pricing methods. The pricing method for intracartel transactions was a modified multiple basing point system having the following elements: (1) each port of shipment was designated a basing point; (2) United States Gulf port published prices were designated as base prices to prevail at each basing point until further notice; (3) freight rate schedules were prepared showing "relative freight rates from each port of shipment to each port of import" and (4) "standardization of quality for various products" was declared to be a cartel objective.

In contrast to this pricing method for internal cartel transactions, the world pricing method up to World War II, as shown in chapter

[29] Italics in the original.

10 of this report, was a single basing point system including the following elements: (1) the common recognition of the United States Gulf as the single, governing basing point; (2) the common observance of the United States Gulf price, as the starting point in the determination of the delivered price; (3) the common use of standard adjustments for differences in quality; and (4) the common use of standard tanker charges from the United States Gulf to ports of destination to be added to the basing point price.[30] The common acceptance of this pricing method by all parties in world trade resulted in a uniform delivered price in each market.[31]

The Gulf-plus pricing system was a structure within which the framers of the Achnacarry agreement could achieve and reserve to themselves substantial economies. Under Gulf-plus, prices in world markets were fixed at the level of prices at the United States Gulf plus standard freight charges from the United States Gulf to consuming markets. So long as the United States, or even the United States and Caribbean areas, were the world's principal sources of crude, it was to nobody's advantage to undercut the Gulf-plus price in any foreign market unless the undercutter was willing to risk a price war—a war which the dominant American companies, because of their size and location, would probably win.

During the 10 years from 1919 to 1928, however, increased production of crude oil, especially in the United States, Venezuela, Russia, Rumania, Iran, and Netherlands East Indies changed the condition of the petroleum market from one of anticipated shortage to what the preamble to the Achnacarry agreement described as "tremendous overproduction * * *."[32]

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[30] See p. 352.

[31] The use of the Gulf-plus method of pricing actually was not new in the industry. In fact, most of the oil companies had long priced their products in this manner, whenever it had been to their advantage to do so. In defense of their system of pricing, industry representatives have frequently attached much importance to the distant origin of Gulf-plus pricing as a "natural" competitive development, dating from the early days when the United States was the world's principal source of both crude and refined petroleum products.

The fact that a given system of pricing has long been in use, however, does not necessarily mean that it originated from the free play of competitive forces. It must be remembered that from about 1882 to the second Standard Oil dissolution in 1911, the original Standard Oil Trust (1882–92), and its successor, Standard Oil Co. (New Jersey) had occupied a virtual monopoly position in both domestic and world trade. (See Report of the Commissioner of Corporations on the Petroleum Industry, pt. 1, Position of the Standard Oil Co. in the Petroleum Industry (1907), ch. II, pp. 48–94.) As a result of the 1911 dissolution order, Standard Oil Co. (New Jersey) distributed its entire stockholdings in 33 subsidiary and affiliated companies. The stock, however, was distributed pro rata to its own stockholders. Hence, although, as a result of the dissolution Standard Oil Co. (New Jersey) ceased to be a holding company, the successor firms were owned by the same interests which had owned the trust—a circumstance which was not likely to give rise to immediate vigorous competition among them.

The development of the Gulf-plus basing point system was facilitated by the continued cohesiveness of the Standard companies, coupled with the fact that the American oil companies, as a group, still continued to account for the bulk of the world supply, particularly after the discovery of the midcontinent and southwestern fields.

[32] According to DeGolyer and McNaughton, op. cit., pp. 23 to 29, the increases for the six countries named, and for the world, during the years from 1919 to 1928, were as follows:

Producing area	1919	1928	Percent increase
	Million barrels	*Million barrels*	
United States	378, 367	901, 474	138. 0
Venezuela	425	105, 749	24, 782. 1
Union of Soviet Socialist Republics	31, 752	84, 745	166. 2
Rumania	6, 618	30, 773	364. 9
Iran	10, 139	43, 461	328. 7
Netherlands East Indies	15, 508	32, 118	107. 1
Total 6 countries	442, 809	1, 198, 320	170. 6
All other countries	113, 066	126, 424	11. 8
Total world production	555, 875	1, 324, 744	138. 3

The continued use of the Gulf-plus pricing system under these changed conditions afforded an unusual opportunity to the framers of the Achnacarry agreement. According to leaders of the oil industry, the United States was producing at increasing costs by tapping deeper reserves and by use of stripping operations in its older and shallower fields.[33] United States domestic production in these areas tended to be high-cost as compared with the flush production of Venezuela and the areas in the Middle East then being opened. Since the Gulf port prices reflected these higher costs of United States output, their use as the base price "values" for the newer producing regions had the effect of basing the export trade structure on high-cost production.

To recapitulate, while market prices throughout the world were to continue on a "Gulf-plus" basis, a modified multiple-basing-point system was set up for intracartel transactions. Through the reciprocal exchange of supplies, the cartel members would each receive their supplies from production centers freightwise most advantageously located with respect to consuming markets. As shown in the official "example" cited above, the savings in transportation costs resulting from the reciprocal exchange of supplies were to be reserved to the cartel members as an "additional profit." The cartel program was further strengthened by the provisions requiring the participants to purchase supplies only from cartel members, to sell supplies to outsiders under their quotas at prices not lower than those charged the marketing organizations of the cartel members, and to sell surplus production above the quotas only to cartel members for resale under their quotas.

Administration of the agreement.—Reference has been made to the cartel's management or administrative agency, which was referred to in the agreement as "an association" or "the association." Its general purpose and membership were described in the following words:

> For the practical carrying out of the arrangement the groups will form an association which shall be managed by a working representative of each group, and each group shall have the right to recall at any time its representative, replacing same by another.[34]

More specifically, the "association" was to make the arrangements necessary to carry out the objectives of the agreement:

> The association shall make arrangements with the marketing organizations owned by each group or by each member of each group and/or with the parent companies that have agreements with marketng organizations, such arrangements to provide that each marketing organization shall maintain its quota of deliveries irrespective of the source of supply and obligate itself to purchase from the groups exclusively all its imports of petroleum products that fall under the arrangements. * * *[35]

To this end, each marketing organization was to report its expected demand for each product. The association was to—

> * * * obligate itself to supply the demand of the marketing organizations and not to sell and deliver to others in the countries in which the marketing organizations operate at prices below those quoted at the time to the marketing organizations.[35]

[33] See p. 220.
[34] Achnacarry agreement, procedural par. 7.
[35] Ibid., procedural par. 8.

The association was to perform the central statistical and sales-management functions necessary to carry out the cartel's objectives. To this end the agreement provided that the association:

1. Would inform the groups as far in advance as possible and keep them currently informed of the total demand for the various products it would need to supply the marketing organizations.[36]

2. Would allocate to each group its quota of each product, and direct shipments to the geographically most favorably located areas.[37]

3. Would administer the pool of member-controlled surplus transportation facilities provided for in the agreement, and furnish from this pool, or from outside tonnage which the association might find it necessary to charter, transportation facilities for any products that the members might elect not to transport in their own ships.[38]

4. Would prepare for 6-month periods in advance, schedules of relative freight rates from each port of shipment, or basing point, to each port of import involved in the agreement.[39]

5. Would post the base prices applicable at each port of shipment.[40]

6. Would request and receive from all members, as soon as possible after January 31 of each association year, sealed bids covering—

> * * * 3 percent of the association's total demand of two grades of gasoline during the preceding year. * * * The bids shall be opened on the first business day after the term for the submission expired and the award shall be given to the group offering the total quantities demanded of stipulated qualities at the lowest price. In ascertaining the price the quantities of each quality shall be multiplied by the price submitted and the group offering the lowest total of such additions shall receive the award. The other groups shall then purchase from such group the quantities offered in proportion to their quota.[41]

The two grades for which bids were requested were to be those "of which the association's demand was the largest during the preceding year." The quantities awarded were to be delivered in cargo lots, in about equal quantities monthly during the ensuing year beginning in May, and no award was to be made "unless at least one group offered during the prescribed time all the quantities of each quality demanded." [41]

Although the purpose of these sealed bids was not specifically stated, it would appear that they were designed to provide a means of disposing of surpluses within the cartel. In other words, this instrument of sealed bids appeared to give effect to a preceding paragraph in the agreement which provided that if any group had a surplus of any product and desired to sell such surplus over and above the quantities which it was entitled to supply under its quotas, it would offer such surplus "to the other groups at a price below that quoted by the association for the product or products in question."[42]

Briefly, then, the association, managed by one representative of each participating group, was to act as the administrative head of the proposed cartel. As such, it would make all necessary subsidiary arrangements and agreements, and act as the cartel's quota-making,

[36] Ibid., procedural par. 9.
[37] Ibid., procedural par. 10.
[38] Ibid., procedural par. 11.
[39] Ibid., procedural par. 12.
[40] Ibid., procedural par. 13.
[41] Ibid., procedural par. No. 15.
[42] Ibid., procedural par. No. 14.

price-fixing, production-allocating, and transportation-assigning agency.

Nature and limitations of the Achnacarry agreement

Although the Achnacarry agreement was worked out after lengthy conferences in which not only the Big Three but other interests participated, and although it was specific in laying down certain procedures, it proved to be more of a statement of things hoped for than a practicable guide for their attainment in particular markets.

This limitation stemmed from its failure to cover the entire petroleum industry. Thus, the regulation of quotas for export covered only part of the marketing operations which would have to be regulated in order to accomplish the "as is" objectives. The number of interests willing to participate might not include all those necessary to assure adequate control of exports into particular markets. Also the number of potential competitors willing to adhere to the agreement and cooperate in maintaining "as is" quotas in one consuming area might be quite different from those willing to cooperate in other markets. There always was likelihood of an outside fringe of uncontrolled competitive exporters and marketers that might disrupt the price structure in particular markets. The maintenance of the "as is" quotas necessitated the control of such outside competition either by agreement or by other means.

Because of these limitations, the Achnacarry agreement is probably best characterized as a constitution, or charter, which, in broad terms, sets out general principles, objectives, and procedures for market stabilization. As such, it left many detailed arrangements to be worked out by its participants both among themselves and with others to whom, or through whom, they sold their products in particular consuming markets.

Whatever attempts were made to put the Achnacarry agreement into effect soon encountered difficulties. Legal counsel for Standard Oil Co. (New Jersey), in submitting a copy of the agreement to the Federal Trade Commission, stated that there were no papers in the company's files indicating when the Achnacarry agreement was terminated, and further, that the association which was to be formed to carry out the agreement "was never formed, and that the export allocation plan, as described in the document, was never carried out." The same source, however, acknowledged that the implementation of a "few" of the seven principles set out in the Achnacarry agreement was the objective of a series of agreements dealing with individual European markets negotiated during the ensuing 8 years. In other words, it appears that the principles set forth in the Achnacarry agreement continued to be regarded as a controlling declaration of group objectives in the formulation of subsequent agreements relating to individual markets, while the procedures for attaining those objectives underwent considerable modification.

WORLD PROPOSALS OF THE AMERICAN PETROLEUM INSTITUTE

At about the time the major oil companies were engaged in drawing up the Achnacarry agreement, the petroleum industry began a campaign to control production in the name of "conservation."

Paradoxically, this campaign began when extensive drilling for new reserves in the United States had resulted in new production sufficient

to allay fears of an impending shortage. Thereafter, domestic production continued to increase to a peak in 1929.[43] As production increased, the oil companies and the United States Government turned their attention from the discovery of new domestic reserves to the conservation of those already proved and in production. To this end the President created the Federal Oil Conservation Board by Executive order late in 1924.[44] Congressional legislation respecting the Board's operations was limited to appropriations to cover the expense of the studies, the object of which was to recommend methods of conservation.

From 1924 to 1928, American petroleum interests cooperated with the Oil Conservation Board in a series of research projects to develop more efficient methods of production and conservation of oil. Among the proposals put forth jointly by the industry and the Board were recommendations for control of production from flush producing fields. This was done as part of an oil-conservation movement which the industry characterized in 1945 as "effective and * * * still in operation in the United States."[45] The conservation controls so described are those embodied in the system of proration of production through interstate compacts.

Coordination of United States conservation with cartel objectives

At one time an effort was made to expand the American conservation pattern into a world-wide movement. The effort was spearheaded by the American Petroleum Institute, which called—

> a conference of representatives of the larger producing companies * * * at New York for informal discussion of the entire problem.[46]

This conference took place on July 30, 1928, antedating the formulation of the Achnacarry agreement by about 6 weeks and:

> Discussion concerned the too rapid development of the fertile oil fields of South America, and a committee was appointed to make a general survey of the situation. Matters assumed a world-wide aspect when in August representatives of American, British, and Dutch oil companies discussed various phases of the subject abroad.[47]

In December 1928, Sir John Cadman of Anglo-Persian Oil Co., addressing a meeting of the American Petroleum Institute, emphasized that "economic cooperation" would solve the industry's problems. Three months later the American Petroleum Institute appointed a Committee on World Production and Consumption of Petroleum and Its Products, with a membership of about 80 representatives of oil companies producing in the United States and South America. On February 25, 1929, the Federal Oil Conservation Board issued a report in which it pointed out that the United States was "exhausting its petroleum reserves at a dangerous rate," and recommended not only cooperation in the development of foreign oil fields, such as those of Mexico and South America, but also larger imports to reduce the depletion rate of the United States.[48]

[43] United States production increased quite steadily from 355,928,000 barrels in 1918 to 732,407,000 barrels in 1923, and thereafter continued to grow at a somewhat similar rate to 1,007,323,000 barrels in 1929 (De Golyer & McNaughton, op. cit., p. 28).
[44] The Federal Oil Conservation Board consisted of the Secretaries of War, Navy, Interior, and Commerce.
[45] American Petroleum Interests in Foreign Countries, op. cit., p. 308.
[46] Ibid., p. 308.
[47] Ibid., pp. 308–309.
[48] Ibid., p. 309.

Three weeks later on March 15, 1929, the first control plan of the American Petroleum Institute's Committee on World Production and Consumption of Petroleum and Its Products was presented at a meeting in Houston, Tex., attended by both Federal and State Government representatives, as well as industry representatives. The committee recommended that 1928 production of crude oil in the United States should be considered as peak requirements for 1929 and subsequent years, proposing in effect that average production in future years be held to the 1928 level. The committee also recommended that a permanent organization be set up in the Petroleum Institute for continuing study of conservation and proper production and use of petroleum products, both in the United States and in foreign countries.[48]

There is a striking similarity between this recommendation and the "as is" quota provisions of the Achnacarry agreement, for under the latter 1928 was also to be the base year for subsequent international quotas set up to implement its principles. One dissimilarity, however, is to be noted; namely, that the conservation recommendations for the United States would permit no increased production over that of 1928, whereas the Achnacarry agreement contemplated increases in production to cover increased world consumption. If United States production could be held rigidly to the 1928 level there would, of course, be no "surplus" production available for export to trouble the cartel. Thus the proposed American conservation control plan would have had the effect of plugging the loophole which, for legal reasons, had been left in the cartel agreement by the deliberate exclusion of the domestic market of the United States and imports into the United States.[49]

The conservation plan was promptly approved by the American Petroleum Institute on March 27, 1929. The proposal apparently had the full support of the leading foreign producers. When the committee's recommendations were before the institute for approval, representatives of both Royal Dutch-Shell and Anglo-Persian Oil Co. were present, and Sir Henri Deterding of Royal Dutch-Shell took a prominent part in the discussions centering around the world oil situation.[50] Sir Henri, in particular, is reported to have offered 100-percent cooperation in foreign fields.[51]

The Federal Oil Conservation Board, which had been kept fully informed of the nature of the plan, was aware that its presentation would raise questions as to the Board's authority to approve such a proposal. Accordingly, on March 20, 1929, 5 days after the committee recommendations had been formulated in Houston and 7 days before they were approved by the American Petroleum Institute, Chairman Wilbur of the Federal Oil Conservation Board sent a letter to Attorney General Mitchell requesting legal advice on the proposed plan. According to the Attorney General's reply dated March 29, 1929, the questions submitted covered:

> * * * whether the Federal Oil Conservation Board has power to approve the proposed agreement and what, if any, effect such approval might have in relieving the parties to the proposed agreement from the operation of the acts of Congress forbidding agreements in restraint of interstate commerce. You also

[48] Ibid., p. 309.
[49] Introduction to principles in the Achnacarry agreement.
[50] The Oil and Gas Journal, July 11, 1929, p. 39; the Petroleum Times, London, March 20, 1929, p. 543.
[51] United States Daily, April 14, 1929; New York Journal of Commerce, March 28, 1929; and American Petroleum Interests in Foreign Countries, op. cit., p. 309.

inquire whether the proposed agreement would violate the antitrust laws of the United States.[52]

After reviewing the conditions under which the Oil Conservation Board had been created by Executive order and taking note of the fact that congressional action had been limited to the appropriation of funds for its expenses, the Attorney General stated in unqualified terms that Congress had not given the Board "any power to grant to any persons immunity from the antitrust laws," and that the Board had "no authority to approve any action which is contrary to an act of Congress or to the antitrust laws of any State." The Attorney General stated further that, on the record—

> The proceedings of the American Petroleum Institute indicate that the purpose of submitting the proposed agreement to the Federal Oil Conservation Board for approval is to obtain a sanction from the Federal Government which may operate to make the parties to the agreement immune from the operation of the antitrust laws.[53]

The institute's plan was submitted to the Oil Conservation Board on April 3, 1929. Chairman Wilbur followed the advice of the Attorney General by notifying the institute on April 8, 1929, that the Board had no legal authority to regulate drilling and production and that the sole authority for such action rested with the States. He suggested renewed discussion "with the State authorities of the three or four principal oil-producing States, particularly to learn if it is not possible for them to enter upon an interstate compact under the provisions of the Constitution authorizing such compacts to which the Federal Government, through congressional action, would be a party." [54] This actually became the procedure by which the domestic petroleum industry, in cooperation with the Federal Oil Conservation Board and State authorities, subsequently worked out the domestic proration controls that are still in effect.

Operation under interstate compact

The stated objective of proration in the United States has always been conservation,[55] i. e., obtaining the maximum total yield of oil from each producing field. Valid technological considerations indicate that this objective is best achieved by operating each field as a unit in such a manner as to maintain the natural hydrostatic and gas pressures necessary to assure maximum total recovery. Proration for conservation alone involves only the limitation of production in each field to those allowables which will maintain those pressures, regardless of the price at which the oil can be sold.

In actual practice, however, the definition of "conservation" used by the oil industry has always combined this technological objective of a maximum total recovery with the market objective of regulating production in order to stabilize prices. Even before there were any State compacts, the quotas suggested by the representatives of the industry or by the advisory committee acting for the Oil Conservation Board were designed to attain the market as well as the technological

[52] American Petroleum Interests in Foreign Countries, op. cit., p. 310.
[53] Ibid., p. 310.
[54] Ibid., p. 310.
[55] Testimony of E. O. Thompson, member of the Texas Railroad Commission, TNEC hearings, pt. 15 (1939), p. 8221.

objectives.[56] Later when Congress was being asked to enact enabling legislation for the interstate oil compacts, various representatives of the large oil companies indicated that to them conservation mainly meant market stabilization. Thus in hearings before the Cole subcommittee (1934) Mr. W. S. Farish, chairman of the executive committee of Standard Oil Co. (New Jersey) testified as follows:

> Mr. WOLVERTON. And what is the underlying thought you have that makes such legislation [to authorize interstate compacts] advisable?
> Mr. FARISH. The underlying thought covered is the whole idea of conservation and stabilization of the industry which to my mind are synonymous terms; they mean practically the same thing (p. 698).

Similarly, Mr. Edward T. Wilson of Denver, Colo., ex-president of Continental Oil Co., stated:

> Mr. MAPES. Now, then, that means in effect that you believe that legislation is desirable for the purpose of stabilizing the industry rather than for conserving the oil?
> Mr. WILSON. That is my personal opinion (p. 341).

Mr. H. F. Sinclair, chairman of the executive committee of Consolidated Oil Corp. of New York, replied to questions as follows:

> Mr. WOLVERTON. Is it not your opinion that when you curtail production that it thereby stabilizes the industry, which includes the price structure?
> Mr. SINCLAIR. I would say so; yes.
> Mr. WOLVERTON. And is not that the real reason why the oil industry has asked for curtailment by the State or the Federal Government?
> Mr. SINCLAIR. I would say that is one of the reasons.
> Mr. WOLVERTON. In fact that is the chief reason, is it not?
> Mr. SINCLAIR. I would agree with you about that (p. 2545).

Representative Marland of Oklahoma testifying in support of the proposed legislation stated:

> The purpose of an interstate compact—real purpose, of course—is to advance the price of petroleum and its products so that petroleum may be produced at a profit (p. 1451).

The basic method of proration of domestic production developed under the interstate oil compacts, as described in testimony before the Temporary National Economic Committee in 1939, includes:

1. Preparation by the Bureau of Mines of the Interior Department of a monthly forecast of the total quantity of domestic crude oil which, added to expected imports, will supply the quantity of crude oil and petroleum fuel products estimated to be needed for domestic use and export during the ensuing month.
2. State authorities follow these estimates in determining the total allowable production for their respective States.
3. Each State authority then allocates its total allowable production to the various producing fields and wells within its political jurisdiction.[57]

In 1939, the Temporary National Economic Committee made an intensive investigation to determine whether or not proration by the States had been used for the purpose of influencing prices. Evidence

[56] Testimony of W. S. Farish in hearings before a subcommittee of the House Committee on Interstate and Foreign Commerce, 73d Cong., on H. Res. 441 (Cole subcommittee, 1934), p. 683. Also, while this procedure was being followed, a tariff was imposed in 1932 on both crude oil and refined products (United States Statutes at Large, vol. 47 pt. 1 (1931–33), p. 259, title IV, sec. 601, par. C. (4)). The tariff rates as imposed in 1932 were:

Crude petroleum and fuel oils, one-half cent per gallon; gasoline and other motor fuel, 2½ cents per gallon; paraffin and petroleum wax products, 1 cent per pound.

[57] TNEC hearings, pt. 17 (1939), pp. 9583–9603, testimony of Alfred G. White of the Bureau of Mines, and pt. 15, pp. 8239–8240, testimony of E. O. Thompson of the Texas Railroad Commission.

developed before the TNEC clearly indicates that the industry understood the principal purpose of curtailment of production imposed by the Texas Railroad Commission to be the maintenance of crude oil prices.[58] Thus, Mr. W. S. Farish, testifying in general terms on October 24, 1939, stated:

> Now I am going on to the price thing. I say unhesitatingly that price has influenced the proration authorities, there isn't any argument about that. The record is so clear that it would be stupid to say it hadn't, and they have been influenced by price. It is quite natural.[59]

When questioned about an order of the Texas Railroad Commission which shut down certain Texas wells for 2 weeks in August 1939, following a reduction of 20 cents per barrel in the price of East Texas crude posted by the Humble and Sinclair companies, E. O. Thompson of the Texas Railroad Commission stated:

> We have been shutting down, as I told you, 2 days a week, sometimes 3, and sometimes 2 weeks at a time. A cutting of price came, and we promptly shut down 2 or 3 days afterward.[60]

Mr. Thompson defended these shut-downs as a necessary conservation measure to prevent the plugging and loss of production of thousands of stripper wells in Texas which, he said, could not afford to operate at a well price below $1 per barrel. He maintained that the effect on price was "purely incidental; like all price reactions are incidental to this proration business." [61] Later, however, he connected past effort under proration with the working off of stocks of crude oil in storage above ground and summarized the reasons for further restrictive action as follows:

> It [the cut] affected our people, and here is what made us indignant about it. Through the years we have been working off these surplus stocks. The industry has been saying through the years that there was too much oil above ground. We all produced heavily in 1936 and 1937, with the result that there was 310,000,000 barrels of oil above ground in storage; it was increasing. Throughout the whole economy of the trade overhanging stocks were condemned as being wasteful because it costs about 20 cents a barrel to store oil per year, and it has been demonstrated in many hearings, testified to many times before our commission, that the lighter ends evaporate, so we have been trying to reduce stocks above ground and have reduced them materially through the last 2 years. They are down now to about 232,000,000 barrels in stocks. When stocks were at the lowest ebb, the lowest in 18 years, consumption was at an all-time high. It didn't seem fair that there should be a cut in price. It gave pause to everyone who was working for the conservation effort.
>
> The CHAIRMAN. Did you think that cut in price was an improper cut?
>
> Mr. THOMPSON. I have said that stocks were low and consumption was high *and if there was anything to the theory of balancing supply and demand when stocks are low and demand is high you should not have declining values.*[62]

Immediately after Texas ordered its shut-down, a special meeting of the Interstate Compact Commission was called at the suggestion of the Governors of Kansas and Oklahoma.[63] The Interstate Compact Commission consisted of the Governors, or their designated representatives, of the States that were cooperating under the interstate oil compact. At this meeting the effects of the proposed price reduction on stripper wells were discussed and a resolution was adopted to the effect that each State would handle its own production

[58] Testimony of E. O. Thompson, TNEC hearings, pt. 15, pp. 8225 et seq., and statement prepared by Carl A. Crowley, TNEC hearings, pt. 14, pp. 7604-7610.
[59] TNEC hearings, pt. 15, p. 9793.
[60] Ibid., p. 8230.
[61] Ibid., pp. 8226 and 8230-8231.
[62] Ibid., p. 8237. [Italics added.]
[63] These States were Texas, New Mexico, Kansas, Oklahoma, Arkansas, and Louisiana.

problems in its own way.[64] O. C. Bailey, chairman of the Arkansas Oil and Gas Commission, testified that following this meeting the representatives of the various States stopped production,[65] and A. Andreas, State geologist and member of the New Mexico Conservation Commission, stated that in New Mexico—

> We hoped by closing all in that the price cut would be restored.[66]

As shown in the TNEC hearings, the history of East Texas prices from the beginning of the efforts by the "compact" States to reduce petroleum stocks was as follows: [67]

Jan. 1, 1936	$1.00
Jan. 9, 1936, through Jan. 5, 1937	1.15
Jan. 28, 1937, through May 18, 1937	1.27
May 22, 1937, through Aug. 29, 1938	1.35
Aug. 29, 1938, through Oct. 10, 1938	1.25
Oct. 11, 1938, through Oct. 22, 1939	1.10

As may thus be seen, prices under proration were advanced during most of 1936 and 1937, followed, however, during the latter part of the period by a decline. At that time "hot oil" was apparently being produced in excess of prorated allowables and sold to independent refiners at prices less than the posted prices quoted above. In fact, it appears that the cut proposed by Humble and Sinclair was designed to reduce the posted price for East Texas to what "hot oil" was selling for. The shut-down ordered by the "compact" States in 1939, plus the failure of other companies to follow, appears to have nullified the proposed cut with the published prices remaining unchanged.[68]

The policy of enhancing prices in the name of conservation, as illustrated by the 1939 shut-down, has generally remained unchanged. Ten years after the TNEC investigation the Senate Small Business Committee, in its final report on oil supply and distribution problems, pointed out that—

> When the Government regulates the supply, the tendency of monopoly to increase its hold on industry is intensified.[69]

Specifically, in regard to the effects of proration, the committee stated:

> There is a mechanism controlling the production of crude oil to market demand (or below) that operates as smoothly and effectively as the finest watch. During

[64] E. O. Thompson, of the Texas Railroad Commission, who was then chairman of the Interstate Oil Compact Commission, described this meeting as follows in a statement filed with the Cole subcommittee in 1940:

"Governor Ratner and Governor Phillips of Oklahoma, called me, as chairman of the compact commission, and asked me to call a meeting of the compact, which I did at their request, in the office of Governor Phillips in Oklahoma City, Okla. * * *

"The meeting was opened by myself, by calling for order and having the entire compact read, as is our custom. Then a discussion was started, State by State, starting with Kansas, then Oklahoma, then New Mexico, in which each State spoke of the tragic effect it would have upon their stripper-well production if the price of oil should be cut.

"I told them that was a situation upon which the compact could not, in my opinion, take any action, but the State of Texas had already acted and had shut down such wells as could be closed down without injury until the period of oversupply was over; and, that coincident with shutting down wells in Texas, we had called a hearing for August 28, at which time a further check on the storage situation would be taken.

"It was decided then, at my suggestion, that a resolution be passed to the effect that each State would handle its own production problems in its own way under its own statutes. Whereupon the meeting adjourned.

"This is as complete a description of the meeting as could be had. I called the meeting. I told them Texas had already shut down. I did not urge any other State to shut down. We simply talked the situation over and each State made its own announcement as to what it intended to do." (See Petroleum Investigation: Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 76th Cong., 3d sess. on H. Res. 290 and H. R. 7372, pt. 4, pp. 2102–2103.)

[65] Petroleum Investigation: Hearings, op. cit., pt. 3, p. 1043.

[66] Ibid., p. 1179.

[67] TNEC hearings, pt. 14, pp. 7578 and 7589–7591.

[68] See also testimony of E. O. Thompson, TNEC hearings, pt. 15, pp. 8238–8239.

[69] Final Report of the Special Committee to Study Problems of American Small Business, U. S. Senate, pursuant to S. Res. 20, 80th Cong., S. Rept. 25, 81st Cong., 1st sess., p. 28.

the year and a half the committee has been investigating the oil industry, there never has been a real over-all shortage of petroleum. Price increases on crude oil have been frequent and substantial, going from $1.25 per barrel at the end of 1945 to $2.65 per barrel in the spring of 1947, with several companies posting $3 per barrel as this report is written. At the time the consumers were feeling the greatest pinch in January and February 1947, there were 220,000,000 barrels of crude oil in storage, mainly controlled by the larger units, which could have been distributed among independent refiners who were running under capacity. But the controlled economy existing in the oil industry needs an absolute balance of supply and demand because it does not contemplate drawing on stocks. When the Bureau of Mines through their monthly forecast of demand underestimated the demand by close to 2 percent for each of the years 1946 and 1947, the spot shortages followed as night the day. The mechanism was wound too tight. Independent refiners could not take more oil out of their own wells because of State proration laws, and the integrated companies would not allow them to take their crude oil except by a processing or tied-in sales agreement. Those cut off of supply by independent refiners or by integrated units desiring to favor one customer over another were suffering, and in turn their customer accounts were without oil. A truly competitive system based only on real conservation practices, could not possibly have held the flow of oil so close to market demand.

The oil-control policies in effect in the United States consist of a series of State and Federal statutes, recommendations of committees made up of integrated-oil-company economists and recommendations as to market demand made by the Bureau of Mines of the Department of the Interior. No single item is in itself controlling; taken together they form a perfect pattern of monopolistic control over oil production and the distribution thereof among refiners and distributors, and ultimately the price paid by the public.[70]

This conclusion of the Senate Small Business Committee in 1949 reveals how well one of the principal objectives of the Achnacarry agreement of 1928 had been attained. Under the Achnacarry agreement the Big Three international oil companies had agreed—

To the extent that production is in excess of the consumption in its geographical area, then such excess becomes surplus production which can only be dealt with in one of two ways: either the producer to shut in such surplus production or offer it at a price which will make it competitive with production from another geographical area.[71]

In 1946, P. H. Frankel, writing with a background of more than 20 years of study and experience in the oil industry in countries on both sides of the Atlantic, summarized the connection between the conservation program in the United States and the industry's efforts to stabilize world production and prices as follows:

There can be little doubt that the American counterparts of this international set-up were "conservation" and "proration" as we knew them in the "thirties." * * * What mattered most, apart from the aspect of technology, where sound argument seemed to support it, was the fact that only with a certain degree of production control could the United States be fitted into the world-wide structure of the oil industry. Conservation was the missing link which had to be forged.[72]

Also an American observer, commenting in 1949 on the industry's hope of maintaining world prices while finding a market for increasing Middle East production, stated:

Involved in the apparent strategy to hold prices, however, is the ability to prevent an excess of crude-oil production in Texas and Venezuela, while at the same time expanding the output of the Middle East. Although the cost of producing crude oil abroad is much less than in the United States, there is the chance that imports at the present rate may not have a decided influence on prices of any products except heavy fuel oil. This is contingent upon the ability of the regulatory bodies of the oil-producing States to hold production in check so that a large proportion of the excess foreign production may be absorbed here until it can be marketed advantageously outside the United States.[73]

[70] Ibid., p. 13.
[71] Achnacarry agreement, principle No. 6.
[72] Frankel, The Essentials of Petroleum, op. cit., pp. 116–117.
[73] J. H. Carmical, Oil Industry Seen in Price Quandary, New York Times, January 25, 1949.

Thus, while the prevention of waste in the use of oil as an exhaustible natural resource is a desirable economic objective, the facts surrounding the initiation of the conservation movement in the United State and the history of its subsequent operation are such as to strongly indicate that the prevention of waste is not the only motive behind the support of the movement by international oil interests. Conservation was urged by the industry, not at the time when it feared the imminent exhaustion of domestic reserves, but during a subsequent period when the discovery of new fields had created an embarrassing surplus in the United States. Moreover, the detailed features of the proposed conservation plan and the subsequent restrictive effects of proration as operated under State compact fitted admirably into the world-wide "as is" agreement of the 1930's by limiting United States flush production and thereby tending to enhance and maintain published Gulf prices which were the base prices or values used in determining world prices. Today these effects appear to be no less important to the industry as a means of maintaining prices in the United States and other markets of the world while a market is found in the United States and elsewhere for greatly increased Middle East production.

It is true that the geographical location of flush production has shifted with the United States becoming an importing nation. Yet in the thinking of the industry proration still is the means of balancing supply with demand in the United States in such a way as to maintain prices. Frankel's conclusion "that the United States price level—that of a high-cost producer—was maintained with the assistance, the collusion if you like, of low-cost producers who, at the same time, acted in accordance with their own interest" [74] appears to fit the 1950's as well as it does the 1930's.

UNITED STATES PETROLEUM EXPORT ASSOCIATIONS

In addition to launching the conservation movement, the American oil companies also sought to implement the Achnacarry agreement through the formation under the Webb-Pomerene Export Trade Act of two export trade organizations, known respectively as the Standard Oil Export Corp. and the Export Petroleum Association, Inc.

It should be noted that the Achnacarry agreement was finally formulated and adopted on September 17, 1928. Standard Oil Export Corp. was incorporated only 2 months later, on November 26, 1928, and Export Petroleum Association, Inc., was incorporated 1 month thereafter, on January 4, 1929, with Standard Oil Co. (New Jersey) personnel taking an active part in its formation and Standard Oil Export Corp. becoming a charter member.

Standard Oil Export Corp.

The first of the two export associations, Standard Oil Export Corp., was designed to centralize control over the export activities of Standard Oil Co. (New Jersey). The corporation, which according to its certificate of incorporation, was formed to engage solely in export trade, was organized with a total of 100 shares of no-par voting com-

[74] The Essentials of Petroleum, op. cit., p. 117.

mon stock. These shares were issued to four companies in the Standard Oil (New Jersey) group, as follows:

	Shares
Standard Oil Co. of New Jersey	40
Standard Oil Co. of Louisiana	25
Humble Oil & Refining Co.	30
Carter Oil Co.	5
Total	100

On December 13, 1928, the corporation's board of directors authorized the execution of marketing agreements with each of the above companies designated as "member companies." These agreements were executed promptly, and on December 18, 1928, the corporation filed its first report as a Webb Act association.

These agreements provided that Standard Oil Export Corp. would engage solely in export trade and the member companies would—

> * * * make no offer, sales, or deliveries in export trade except through, to, or by the corporation, or in such manner as the corporation shall from time to time determine as regards prices, terms, and conditions of sale.

These member contracts were for an indefinite period, but were terminable after 1 year's notice. Any disagreement between a member and the corporation was to be resolved by vote of the corporation's board of directors. The corporation's organization and operating expenses were to be assessed against the member companies in proportion to the quantities exported or sold for export by the member companies. All other expenses were to be assessed against member companies in accordance with the number of shares owned by each.

Limitations of Standard Oil Export Corp.'s authority.—Standard Oil Export Corp. had no corporate connections with American companies outside the Standard (New Jersey) group and made no contracts to represent other American interests. It served two purposes in the export trade of Standard Oil Co. (New Jersey).[75] First, it established a single centralized corporate control over the export trading activities of the parent company's principal producing and exporting subsidiaries. Second, as the corporate agency exercising this control, it coordinated its activities with the requirements of the international agreements entered into by the parent company. That it actually assumed the parent company's responsibilities under those agreements is indicated by its reply to an inquiry of the Federal Trade Commission on June 19, 1929:

> * * * the "Corporation" has conducted negotiations with certain foreign companies, as permitted by the Webb Act, in an effort to assure the maintenance of the export trade of the "Corporation." As a result of these negotiations, the "Corporation" has a verbal understanding with these foreign companies whereby it is recognized by such foreign companies that the member companies have heretofore built up over a period of years a large export trade in petroleum products which the "Corporation" and its members companies are entitled to maintain.

Standard Oil Export Corp.'s position in international trade was strengthened about a year later by its acquisition of Anglo-American Oil Co., Ltd. Since 1911, this company had functioned in England as a formally independent refiner and marketer of petroleum products,

[75] For clarity herein, the parent Standard Oil Co., a New Jersey corporation, is referred to as Standard Oil Co. (New Jersey) to distinguish it from its subsidiary, Standard Oil Co. of New Jersey, which is a Delaware corporation.

a large part of which it purchased from Standard Oil Co. (New Jersey) interests.[76] The action of Standard Oil Export Corp. in purchasing Anglo-American Oil Co., Ltd., was directly related, on the one hand, to the operations of the Export Petroleum Association in pricing and allocating United States exports of petroleum, and on the other to the marketing of petroleum in Great Britain and other areas in which Anglo-American Oil Co., Ltd., operated.[77]

Export Petroleum Association, Inc.

On October 3, 1928, 3 months before the Export Petroleum Association, Inc., was incorporated, a tentative plan for its formation was submitted to the Federal Trade Commission by C. O. Swain, general counsel of Standard Oil Co. (New Jersey) and Gilbert H. Montague, counsel in the organization and operation of both the Standard Oil Export Corp. and the Export Petroleum Association, Inc. The introduction to the plan stated that:

> Only by effecting all the possible economies in the conduct of its foreign business can the American petroleum industry hope to overcome the handicaps which have come naturally and progressively to inhere in its position in the world trade.
>
> On relatively high costs of production in the United States is superimposed a condition of intense competition among the various American units for position abroad resulting in unnecessary duplication of marketing facilities, unnatural cross-freighting of supplies and other uneconomic burdens upon the cost of distribution.

The nature and purpose of the association, as stated by its certificate of incorporation, were set forth as follows:

> To engage solely in export trade, as the term "export trade" is defined in the act of Congress entitled "An Act to promote export trade, and for other purposes," approved April 10, 1918, commonly known as the Webb Act, and any and all acts amendatory thereof or supplementary thereto, and in connection with such export trade to do any and all things necessary or incidental thereto * * *.

The association was established as a nonprofit cooperative service organization with an authorized capital stock of 100 shares without par value. These shares were to be issued to members, or to the nominees of members, who executed membership agreements with the association. Only one share was to be issued to each member, and

[76] Anglo-American Oil Co. was organized in England in 1888. It was one of the thirty-odd subsidiaries of which Standard Oil Co. (New Jersey) was required to divest itself under the United States Supreme Court's decision of May 5, 1911. Divestiture was accomplished by Standard Oil Co. distributing its holdings in these subsidiaries to its own stockholders. Thus, Anglo-American Oil Co., Ltd., became a legally separate corporate entity, but continued to be allied closely in interest with the Standard group, from which it purchased large quantities of crude oil and refined products which it marketed mainly in the United Kingdom and North Africa. To acquire this former subsidiary, Standard Oil Export Corp. amended its charter to permit the issuance of 5 percent nonvoting preferred stock which was guaranteed jointly and severally as to both par value and cumulative dividends by the member companies of Standard Oil Export Corp. Final acquisition of Anglo-American's total outstanding stock was completed in 1930 by the issuance of 764,935 shares ($76,493,500 par value) of Standard Oil Export Corp.'s preferred stock, on the basis of one $100 par value preferred share for each 5⅚ shares of £1 par-value Anglo-American ordinary stock. Later, on June 28, 1935, Standard Oil Co. (New Jersey) acquired the voting shares of Standard Oil Export Corp. formerly owned by Humble Oil & Refining Co., and assumed Humble's incidental guarantee with respect to the Export Corp.'s outstanding nonvoting preferred. On June 30, 1936, Standard Oil Export Corp.'s entire issue of preferred was called at $110 per share. Moody's Industrials, 1933, p. 292; and 1936, p. 2570.

[77] Standard Oil Export Corp. was bound by its membership in Export Petroleum Association to observe the prices and terms fixed by that association. On this basis, Standard Oil Co. (New Jersey) interests continued to sell to Anglo-American Oil Co., Ltd., as their principal British outlet exactly as in the past. The separate corporate entity, however, drew a boundary line between the export corporation's operations in the United States and the operation of its American-controlled British subsidiary in foreign markets. The latter took title to products exported from the United States on delivery to the ship. Beyond this, the Anglo-American company operated on its own account in the United Kingdom as a separate legal entity. After Standard Oil Export Corp. acquired control of Anglo-American, Standard (New Jersey) interests were in a position to exercise closer control over the operations of the Anglo-American company and its foreign subsidiaries than had existed at any time since the dissolution of Standard Oil Co. (New Jersey) in 1911.

Moreover, the acquisition gave Standard Oil Co. (New Jersey) a controlled marketing company in the United Kingdom that it could direct and depend upon to carry out the commitments made by the chief executives of Standard Oil Co. (New Jersey) respecting the observance of the "as is" principles and procedures of Achnacarry agreement, particularly with respect to pricing problems and other matters arising in the distribution of "as is" quotas in the United Kingdom.

the shares so issued were not assignable or transferable except with previous consent of the association's board of directors. In case of default or breach of contract by any member company, the board of directors might, by resolution adopted with the assent of two-thirds of the directors, declare the member's agreement terminated. The cancellation of any member's agreement also required that the certificate of stock standing in the member's name be also canceled and the stock returned to the association.

Membership and terms of membership agreements.—In accordance with these charter provisions, membership agreements were promptly executed by the association and 15 American oil companies, including the Standard Oil Export Corp. One additional member joined in 1929 and one in 1930, to make a total membership of 17 companies, as follows:

Atlantic Refining Co.
Cities Service Co.
Continental Oil Co.
Gulf Refining Co.
Maryland Oil Co.
Pure Oil Co.
Richfield Oil Co.
Shell-Union Oil Corp.
Sinclair Consolidated Oil Co.
Standard Oil Co. of California
Standard Oil Co. (Indiana)
Standard Oil Co. of New York
Standard Oil Export Corp.
Texas Corp., The
Tidewater-Associated Oil Co.
Union Oil Co. of California
Vacuum Oil Co.

In defining the rights and duties of the parties, the membership agreement said only that "* * * the member company shall be governed by and shall carry into effect" with respect to "all offerings, sales, or deliveries in or for export trade hereafter made by, for, or in behalf of the member company" all determinations that were made by (*a*) the association's export price committee with respect to prices; (*b*) the association's quota committee with respect to export quotas, and; (*c*) the association's general committee with respect to "all other conditions and details of all offerings, sales, or deliveries in or for export trade."

These provisions were supported by the association's bylaws, which required the board of directors to delegate absolute authority to these three committees to determine the association's pricing and operating policies and procedures. The members, in turn, agreed to abide by the decisions of these three committees in all export operations, whether actually by the members themselves, or by their agents, or through the association.

The decisions of each of the committees were to be by unanimous consent of all members of the committee. Each of these committees consisted of one representative of each contracting member company. Thus, all actions of the association, except those dealing with assessments, dissolution, and election of officers, could be blocked by the dissent of a single member. This unanimous-consent rule slowed down the association's operations and contributed powerfully to its ultimate collapse.[78]

As a result of the affiliation of Standard Oil Export Corp. as one of the charter members of the Export Petroleum Association, the wide-

[78] In reporting to the Federal Trade Commission on May 27, 1929, the vice president and general counsel for Export Petroleum Association, Inc., stated that—

"This association rule was the only basis on which the member companies were willing to enter the association.

"Among the association constituent member companies there are examples of each and every known variety of exporter in the entire American export trade in petroleum and petroleum products.

* * * * * * *

"This association rule, however, inevitably involves great delay in action by the association on any subject whatsoever, and that is why the association has not made faster progress."

spread operations of Standard interests were intermingled with the operations of the export association. Similarly, Royal Dutch-Shell was represented through the membership of Shell Union Oil Corp., an American subsidiary.

The association took its first responsibility for the export activities of its members on January 18, 1929, on which date it appears to have assumed jurisdiction over export sales of gasoline and kerosene. The record also indicates that it proposed to assume jurisdiction over its member companies' export sales of crude oil on April 9, 1929.[79]

Price actions by the association.—Before the export association could begin to function it was necessary for its price, quota, and general committees to arrive at determinations in their respective fields. Just when the first actions on these subjects were actually taken is not clear, but on April 2, 1929, the export price committee issued a "Resolution and Determination Effective January 18, 1929, as Amended by Amendments Effective March 30, 1929, and amendment Effective April 2, 1929." This document fixed the export prices for four grades of gasoline and two grades of kerosene—

> In bulk f. o. b. U. S. Gulf, shipments within 60 days, and payments to be made in cash on date of shipment, otherwise cost of financing to be added in full. If beyond 60 days, price prevailing date of shipment.[80]

Prices at North Atlantic ports were to bear a differential of ¼ cent per gallon over Gulf prices except on shipments to France, which were to be at Gulf prices plus actual freight differential from Gulf ports as compared with North Atlantic ports. An amendment, effective March 30, 1929, added 1 cent per gallon to port prices when sales were made to nonmember buyers, thus establishing a price handicap against nonmember exporters buying from members.

Prices for gasoline and kerosene f. o. b. California ports for shipment to points east of the Panama Canal were to be Gulf prices less California's actual freight disadvantage. Shipments from California to the Dominion of Canada and west coast of South America were not to—

> be below the equivalent of the * * * Gulf prices for similar products after making proper allowance for transportation costs, etc.

These provisions indicate the use of a system of basing-point pricing, with Gulf ports as the basing point and Gulf port prices fixed by the association as the base prices. California producers were required to meet the Gulf prices in all destination areas, absorbing freight on shipment to those areas where Gulf shippers had a freight advantage and enjoying phantom freight in those areas where they had the advantage.[81]

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[79] The statistical report of the association for 1929 indicated that the association exercised some control over crude oil exports in 1929; but its 1930 report covered only kerosene and gasoline.

[80] The prices fixed were as follows:

	Cents per American measured gallon at 60° F.
Gasoline:	
40 to 45 percent off at 212°, 375° final	10
25 to 30 percent off at 212°, 390° final	9¾
25 to 30 percent off at 212°, 400° final	9½
U. S. Navy	8½
Kerosine (export prices effective Jan. 18, 1929, were raised, by amendments effective Mar. 30, 1929, so as to read as follows):	
Water white, 44 API plus 21 color	8¾
Prime white	7¾

[81] Shipments of California oil to Pacific Ocean destinations west of California, however, were to be handled somewhat differently. For such shipments it was provided that Gulf-plus basing-point pricing would apply if and when the prices in those markets—some of which had apparently been characterized by price competition—were so "corrected" as to yield the Gulf prices plus the "established" transportation differential, plus a "fair profit."

Efforts to obtain adherence of western independent producers.—Control of American exports by the export association was difficult without the cooperation of independent producers, refiners, and exporters. In order to bring the western independent firms into the fold, negotiations were carried on with the Western Petroleum Refiners Association.[82] The result of these negotiations was a draft, dated May 9, 1929, of a "Plan and agreement dated as of May 1, 1929, for a proposed Western Petroleum Refiners Export Bureau," consisting of members of Western Petroleum Refiners Association. Members would contract with the bureau for a period of 8 months from May 1 to December 31, 1929, during which time they would agree to make offerings, sales, or deliveries of gasoline and kerosene for export only to or through the bureau—

> * * * in such manner and in such proportions as shall be satisfactory to Export Petroleum Association.

As the quid pro quo the Export Petroleum Association would endeavor to purchase kerosene and gasoline from the Bureau. The quantities to be purchased were to be determined in part:

> * * * by quantities which Western Petroleum Refiners Export Bureau desires to sell during the period of proposed contract, it being understood that Export Petroleum Association, Inc., will endeavor to purchase quantities equal to quantities purchased by all of Export Petroleum Association, Inc.'s member companies from all of Western Petroleum Refiners Association members during the last 8 months of 1928.

Orders covering such purchases were to be placed by the Export Petroleum Association with the Bureau, which, in turn, would allocate them among its members in proportion to the quantities made available to the Bureau by its members, "* * * having due regard for particular conditions affecting particular Bureau members and particular member companies of Export Petroleum Association, Inc." Bureau members were to fill orders so allocated and payments were to "be made direct by Export Petroleum Association, Inc.'s, member company handling shipment."

This arrangement went beyond the commercial relationship previously prevailing between individual members of Petroleum Export Association and individual independent producers. Under the proposed arrangement, Bureau members were to export exclusively through the Bureau, which, in turn, was to find a market for its exports exclusively through the Export Petroleum Association. Leakage of products to outsiders would have been effectively blocked. Together with the 1 cent per gallon price handicap, this exclusive dealing arrangement would have practically closed the market to nonmember exporters. So far as the record shows, this arrangement was never put into effect.

Final collapse of Export Petroleum Association efforts.—The proposal to form the Western Petroleum Export Bureau was only one of a number of efforts made to set up a working organization. These efforts continued throughout 1929 and 1930 under the direction of Gilbert Montague, vice president and general counsel. During these years no president or treasurer was elected, and officially the work of the association was carried on entirely by Mr. Montague and the board of directors, consisting of one representative from each of the con-

[82] Western Petroleum Refiners Association, with headquarters in Tulsa, Okla., appears to have had a membership of approximately 60, consisting mainly of independent refiners in the midcontinent field.

tracting members. No further products were brought under the association's control, and its operations respecting kerosene, gasoline, and crude oil appear to have been carried on under mounting handicaps. Export prices were fixed by the association, but with increasing difficulty owing to the "unanimous consent" rule. The quota committee attempted to establish export quotas for its members, based on their export performance in 1928, but it, likewise, experienced the same problem. In the meantime it appears that some of the members tried to base their 1929 export performance on their percentage ratios of 1928.[83] This apparently means that they were attempting to operate individually in accordance with the Achnacarry agreement.

A year later, Mr. Montague reported on June 30, 1930, that the association was still in its formative and experimental stage and that—

> The chief obstacles encountered by the association are those inherent in working out a program for cooperation in export trade which will be satisfactory to the diverse interests of the 16 member companies of the association.

The association continued to operate in a limited way until November 7, 1930, when its export price schedules were canceled. Thereafter it became inactive and remained dormant until it was formally dissolved in June 1936.

Proportions of United States total exports controlled by Webb Act associations

The influence of the two associations on United States petroleum exports is reflected in the following table, which is based on incomplete statistical reports made by the Standard Oil Export Corp. and the Export Petroleum Association for the years 1929–36.

TABLE 13.—*Combined exports of Standard Oil Export Corp. and Export Petroleum Association, Inc., compared with total exports of petroleum and its products from the United States, 1929–36*

Year	Standard Oil Export Corp. total exports	Export Petroleum Association (for members other than Standard Oil Export Corp.)	Total Standard Oil Export Corp. and Export Petroleum Association	Total United States exports (petroleum and its products) [1]	Percent by Export Petroleum Association and Standard Oil Export Corp.
1929	$140,240,000	$111,000,000	$251,240,000	$561,191,000	44.8
1930	113,185,000	[2] 99,605,000	212,790,000	494,339,000	43.1
1931	57,943,000	(3)	57,943,000	270,500,000	21.4
1932	44,195,000	(3)	44,195,000	208,381,000	21.2
1933	33,400,000	(3)	33,400,000	200,016,000	16.7
1934	41,500,000	(3)	41,500,000	227,537,000	18.2
1935	37,500,000	(3)	37,500,000	250,326,000	15.0
1936	[4] 19,000,000	(3)	19,000,000	263,149,000	[5] 14.2

[1] Source: Commerce and Navigation.
[2] Estimated as same proportion of Export Petroleum Association's total as in 1929.
[3] Export Petroleum Association inactive.
[4] 6 months, January 1 to June 31.
[5] Assuming exports of last half equal those of first half of the year.

Source: Reports of Standard Oil Export Corp. and Export Petroleum Association to the Federal Trade Commission.

[83] In May 1929 a report to the Federal Trade Commission explained that—

"* * * difficulties, obstacles, and conflicting interests have delayed the association in establishing quotas for the association's constituent member companies, so that each of the association's constituent member companies is now taking as much of the association's total export trade as such member company secures at the export price schedules adopted by the association effective January 18 and April 9, 1929.

"The association has now a committee actively engaged in compiling data to enable the association to determine the quotas of the association's constituent member companies in the association's total export trade.

"Some of the association's constituent member companies, believing that these quotas when adopted will be approximately in the ratios established by 1928 experience, have voluntarily tried to maintain their 1929 shares in the 1929 export trade in approximately the above ratios. * * *"

The maximum degree of control exercised by the Webb Act associations was reached in 1929, when nearly 45 percent of the total value of all United States petroleum exports were made by these two organizations. With the collapse of the Export Petroleum Association, the degree of control fell sharply. The proportion controlled by Standard Oil Export Corp. also decreased steadily from 21.3 percent in 1931 to less than 15 percent in 1936. Thus it appears that the movement to establish effective single control over American export trade was a failure.

Foreign influence in Export Petroleum Association operations

The reason most frequently assigned for the collapse of the Export Petroleum Association was the inability of the American interests to agree on prices through unanimous action by the price committee. There is evidence, however, that at least as early as August 1929, the question of the propriety of a price increase proposed by the association was the subject of discussion among international interests meeting in London. Trade press reports of the time indicate that any difference of views among American interests constituting the association was also shared by foreign interests. The July 13, 1929, issue of The Petroleum Times (London) stated that opinions for and against the association's proposed price increase:

> * * * have been so much at variance that the matter has been referred back to the export-price committee for further consideration. It is reported that whilst the Standard interests favor an immediate increase in price, an equally important section with Royal Dutch and Shell interests is against such a move on the grounds that it would be contrary to good business practice to raise prices in the face of the current continual increase in production. * * *.[84]

The Petroleum Times reported, further, that Royal Dutch-Shell interests opposed the proposed price increase on the grounds that curtailment of crude production had broken down in America, and that a price increase would create distrust of the American oil industry in European consuming markets.[85] A little later, the same trade magazine reported that the question whether Export Petroleum Association, Inc., should increase its prices was discussed further at a secret oil conference in London in August 1929.[86] Thereafter, the association found it increasingly difficult to obtain agreement on export prices because of disagreement both within and outside its membership. This situation continued for more than a year, until its price schedules were finally canceled.

Thus it appears that the breakdown of the Export Petroleum Association stemmed from the inability of foreign and American interests to agree on American export prices. Dissent by a foreign company, expressed through its American subsidiary, could effectively block the unanimous price action necessary under the association's unanimous-consent rule. Royal Dutch-Shell was in a position to make its opposition effective through the membership of its subsidiary, Shell Union Oil Corp. Who cast the dissenting vote or votes is not known, but it is apparent that the dissent was based on the objections of British and Royal Dutch-Shell interests expressed in London.

The two principal reasons assigned in the foreign press for the objections by foreign interests were (1) that curtailment of crude production had broken down in America, and (2) that it would not be good busi-

[84] Petroleum Times, London, July 13, 1929, p. 47.
[85] Ibid., July 20, 1929, p. 132.
[86] Ibid., August 10, 1929, p. 239.

ness practice to raise prices in the face of continued increases in production. The price increase, if permitted to the Americans, would have raised the entire world price structure through the use of American Gulf-port prices as the base prices for world trade, as outlined by the Achnacarry agreement. Such a general enhancement of world prices would have still further stimulated world production. The foreign interests were, therefore, taking the long-range view that until world production, and especially American production, had been brought under control, a price increase to cover the allegedly high marginal cost of producing in America would be undesirable.

Relation to Achnacarry agreement

On the basis of information appearing in the foreign press suggesting a close connection between the export associations and the movement to cartelize the world oil trade, the Federal Trade Commission asked both the Export Petroleum Association and Standard Oil Export Corp. for information regarding their relations with foreign interests. In reply each stated that it had "verbal understandings" under which "certain foreign companies" agreed to respect the volume which member companies had in 1928, plus the normal increase.

Specifically, in May 1929, Export Petroleum Association described the objective of its negotiations as being to insure the "as is" position of its members in world trade, and described that position practically in the language of the Achnacarry agreement.[87] Standard Oil Export Corp. likewise stated by letter in June 1929 that it had such an understanding with certain unnamed "foreign companies" in consideration of which it agreed not to expand its export trade beyond "the 1928 volume of its member companies, plus the normal increase." [88]

After receiving these communications, the Chairman of the Federal Trade Commission, on July 2, 1929, pointed out to both Webb Act associations that it was not the purpose of the Webb Act to allow exporters to combine with foreign producers or distributors to the detriment of production and trade in the United States, and expressed the Commission's opinion—

> that the verbal understandings or agreements with foreign companies entered into by your corporation are of doubtful legality, since a limitation of exports to the 1928 level, in this country and abroad, may result in a corresponding limitation of production, and a restriction of the free flow of trade in interstate and foreign commerce, in violation of the Sherman Act, the Federal Trade Commission Act, and the Wilson Tariff Act.

[87] The association's statement to the Commission on this point was as follows:

"Since the association's main purpose is to protect and assure the export trade previously handled by the association's constituent member companies, steps have been taken in behalf of the association, as permitted by the Webb Act, in negotiations and in conferences with foreign producers and foreign distributors and in meetings of the association, in the effort to assure to the association, as against foreign producers, a volume of export trade equal to that previously handled by the association's constituent member companies, plus natural increases; in other words, to insure that, as permitted by the Webb Act, the 'as is' position, by which is meant the ratios established by the 1928 performance, shall as nearly as possible be maintained as regards all petroleum and petroleum products exported from all countries of production (excepting all imports into the United States) and as regards all petroleum and petroleum products distributed in foreign countries."

[88] Standard Oil Export Corp. stated:

"With further reference to the operations of the corporation, you are advised that the primary purpose of the corporation is to protect and assure the export trade previously handled by the corporation's constituent member companies. With this purpose in mind, the corporation has conducted negotiations with certain foreign companies, as permitted by the Webb Act, in an effort to assure the maintenance of the export trade of the corporation. As a result of these negotiations, the corporation has a verbal understanding with these foreign companies whereby it is recognized by such foreign companies that the member companies have heretofore built up over a period of years a large export trade in petroleum products which the corporation and its member companies are entitled to maintain. The volume of export trade of the corporation, which these foreign companies have agreed to respect, is the volume which the member companies had in 1928, plus the normal increase. In order to be assured of maintaining its position in the export trade, the corporation has agreed that it will not expand its export trade beyond the 1928 volume of its member companies plus the normal increase, where such expansion would result in depriving these foreign competitors of the volume of business in foreign markets which they enjoyed in 1928, plus the normal increase thereof."

In reply, C. T. White, secretary of Standard Oil Export Corp., took the position that his company had not entered into any combination with foreign producers to the detriment of trade and production in the United States, or which would restrict the trade of competitors exporting from the United States.[89] On the contrary, he defended the understandings as an attempt carried out under the provisions of the Webb Act to assure maintenance of the volume of American export trade in the face of competition from lower-cost foreign oil.[90] Later, on October 14, 1929, the Commission again asked each of the Webb Act associations whether it had taken any further action in the matter of agreements with foreign producers or distributors. The Export Petroleum Association replied that it had no agreements with any foreign producers or distributors, and Standard Oil Export Corp.'s secretary stated that

> this company has taken no further action in the matter of agreements with foreign producers or distributors since the report contained in my letter of June 19, 1929.

Thus, in America, the observance of the "as is" principle was presented as an effort under the Webb Act to maintain and increase American export trade. In foreign circles, however, where less official secrecy surrounded the cartel's methods and objectives, the "as is" principle was regarded as the basis for dividing world markets, restricting world production, and thereby enhancing prices; and Export Petroleum Association was regarded as one of the instruments of implementing the "as is" principle. This point of view was described in The Economist (London) as follows:

> As far as marketing is concerned, international cooperation is not only possible, but it is being increasingly extended. This is due to the fact that the international oil export trade is largely in the hands of three groups—Standard Oil, Royal Dutch-Shell, and Anglo-Persian. At the end of last year the Standard Oil Co. of New Jersey took the lead in forming the American Oil Exporters Association, of which every American oil company of importance is now a member. This association fixes the prices at which oil products can be exported from American ports. Representatives of the association conferred this year with representatives of the Royal Dutch-Shell and Anglo-Persian groups, and agreed upon a division of territories in the European markets. An example of the effectiveness of international cooperation in oil marketing is Great Britain, where the three groups -Shell, Anglo-Persian, and Standard Oil of New Jersey, which is now taking over complete control of its subsidiary, Anglo-American Oil—have not only agreed upon selling prices and the number of pump installations, but have secured an agreement with the Russian Oil Trust fixing its proportion of the British trade. The stability of petrol and other refined oil prices in the British, European, and Eastern markets is the measure of the cooperation between Royal Dutch-Shell, Burmah Oil, and Anglo-Persian on the one hand and the Standard Oil companies on the other.[91]

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[89] The provisions of the Webb Act in this respect are as follows:

"SEC. 2. That nothing contained in the Act entitled 'An Act to protect trade and commerce against unlawful restraint and monopolies,' approved July second, eighteen hundred and ninety, shall be construed as declaring to be illegal an association entered into for the sole purpose of engaging in export trade and actually engaged solely in such export trade, or an agreement made or act done in the course of export trade by such association, provided such association, agreement, or act is not in restraint of trade within the United States, and is not in restraint of the export trade of any domestic competitor of such association: *And provided further*, That such association does not, either in the United States or elsewhere, enter into any agreement, understanding, or conspiracy, or do any act which artifically or intentionally enhances or depresses prices within the United States of commodities of the class exported by such association, or which substantially lessens competition within the United States or otherwise restrains trade therein."

[90] Standard Oil Export Corp.'s understanding with foreign oil companies was described as:

"* * * an effort to assure the maintenance of the volume of export trade of the corporation in the face of conditions existing in the world oil situation which threaten to diminish seriously the volume of export trade of this corporation unless some method is found to carry out the understanding. Since crude petroleum and products derived therefrom are produced abroad at much less than the cost thereof in this country, some agreement with foreign oil companies is necessary in order that American companies may maintain their position in export trade. Without some such understanding as Standard Oil Export Corporation is trying to work out under the provision of the Webb Act, American export trade in petroleum and its products cannot hope to withstand the foreign competition."

[91] The Economist (London), December 21, 1929.

As noted in The Economist's article, Standard Oil Co. (New Jersey) was one of the Big Three that formulated the Achnacarry agreement. Its officials also took a leading part in organizing Export Petroleum Association, Inc., in promoting the American and world conservation movements, and in carrying out other steps to implement the Achnacarry agreement. The collapse of the Export Association was so discouraging to some Standard Oil Co. (New Jersey) officials that they seriously questioned the desirability of continuing their "as is" understandings after its demise. This reaction indicates in a negative way that, as The Economist indicated, the Export Association was expected to carry out an important function in the world cartel movement. This reaction took definite form less than 4 months after the association suspended operations. On March 2, 1931, E. J. Sadler, vice president of Standard Oil Co. (New Jersey) addressed a letter to three other high Standard officials in which he stated in part:

> I recently wrote Mr. Teagle that I thought in view of the collapse of the Export Association, our as-is arrangement with the Royal Dutch should be abrogated, and likewise with an as-is arrangement in territories where it was mutually advantageous.
>
> * * * * * * *
>
> In many places I think our as-is agreement with the Royal Dutch allows third parties to come in and take a percentage of the trade, while handicapping either the Royal Dutch or ourselves in maintaining or increasing the 1929 percentage of the two interests added together.[92]

Had these suggestions been followed, the effect would have been to increase the opportunity for competition in the world industry. However, other new control measures were then under consideration, and the suggestion was not adopted. Instead a new understanding was formulated by the Big Three for control of competition in European markets. This understanding likewise was founded upon the "as is" principle, in harmony with the statement that "it is understood between the three parties concerned that the main principle is of a durable nature." [93]

MEMORANDUM FOR EUROPEAN MARKETS, 1930

Following the collapse of the Export Petroleum Association, Inc., in November 1929, there were rumors in the European trade that vigorous competition might assert itself in the international petroleum industry. These rumors were based on the assumption that American producers, freed from their obligation to sell only at the export prices fixed by the association, might retaliate against Royal Dutch-Shell by moving into its markets. That company had been importing into the United States large quantities of low-cost oil from Venezuela [94] to be refined and marketed by its American subsidiary, Shell Union Oil Corp. On the other hand, there also were rumors of closer collaboration among the large producers.[95]

[92] The third parties here mentioned included other American interests who were free to compete in foreign markets following the collapse of Petroleum Export Association's activities.
[93] Addendum to Memorandum for European Markets, January 20, 1930, p. 1.
[94] The Petroleum Times, London, November 15, 1929, pp. 789-790.
[95] Ibid., March 1, 1930, p. 380, stated:
"But notwithstanding the large share of the United States oil industry in the world production of oil, that industry alone cannot obtain effective control of oil production without the cooperation of the large producers outside the United States, and there is no doubt that this exists to a considerable degree."

The latter rumors proved to be the more correct. The foreign oil trade press reported that in 1929 and 1930, the cooperative relationships between Anglo-Persian and Royal Dutch-Shell in Africa and the East were strengthened,[96] and that Jersey Standard and Shell were adjusting their differences in the East Indies and Asia.[97] In the Western Hemisphere the United States Tariff Commission reported in January 1931 that—

> Under a gentleman's agreement, restriction of crude oil production in Venezuela has been in effect for some time—

and that—

> In response to a resolution of Oklahoma oil producers in December 1929, the Royal Dutch-Shell proposed in February 1930 curtailment of Venezuelan production for the year, proportionate with the year's curtailment compared with 1929 in the United States.[98]

Trade press comments respecting control of production in other producing areas were to the effect that late in 1930, Royal Dutch-Shell was prepared to shut in substantial quantities of production in Rumania, the Dutch East Indies, Mexico, and Venezuela, provided American companies would do likewise;[99] and that early in 1931 Standard also agreed to limit its production in Venezuela and to reduce imports into the United States.[1] It thus appears that control of production in foreign countries hinged upon control of production in the United States.

Thus, it can be seen that although the efforts to establish world-wide controls through the media of the American Export Association [2] and the American conservation movement were not completely successful, they laid the ground work for attacking the problem in a more realistic manner—i. e., through (1) direct control of production in particular flush-producing fields and (2) marketing agreements and understandings in particular marketing areas. The large companies apparently realized that although it was practically impossible to devise a single world-wide cartel agreement to which all of the diverse oil interests of the world would adhere, it was not impossible to establish controls of both production and marketing on a "piecemeal" basis. As E. J. Sadler, vice president of Standard Oil Co. (New Jersey) phrased the matter in 1931:

> The making of a world-wide agreement is more difficult to obtain than accomplishing the result piecemeal. Economically, there are local situations which can be consolidated with a much sounder economic basis than to immediately attempt to jump to a position of world-wide distributions.[3]

[96] Ibid., June 14, 1930, p. 1054.
[97] Ibid., December 6, 1930, pp. 913.
[98] U. S. Tariff Commission, Cost of Petroleum, 71st Cong., 3d sess., Doc. 267, January 26, 1931, p. 20.
[99] The Petroleum Times, December 6, 1930, p. 913.
[1] Ibid., April 4, 1931, pp. 477-478.
[2] That the indirectness of control of production through the Achnacarry agreement and Export Petroleum Association's activities was recognized by the Big Three is evidenced by the following from a Memorandum of Meeting at Sir Henri's House on Saturday, May 4, 1929:
"The curtailing or prorating production will be an indirect result insofar as members will have for their production as a regular outlet only what their respective quotas give them. However, the Achnacarry principle does not in any way restrict, in itself, the production of members, as is shown by the provision that each party can produce any surplus it likes, provided, and to the extent that it can find an extra outlet for such surplus by offering it to the other pool members at a price which makes it attractive to them to shut down production."
[3] While this statement was made in a memorandum dealing with matters of internal policy of Standard Oil Co. (New Jersey), it is, nevertheless, an incisive commentary on the world international oil situation.

In establishing controls on a "piecemeal" basis, the first step was the drafting of a new international agreement entitled "Memorandum for European Markets," which bears the date of January 20, 1930. The direct connection between this new document and the Achnacarry agreement is indicated by the following statement made by Standard Oil Co. (New Jersey) in submitting a copy of the memorandum to the Commission:

> A few of the principles with respect to marketing arrangements abroad, which were expressed in the document entitled "Pool Association" [Achnacarry agreement], were implemented by the document entitled "Memorandum for European Markets," dated January 20, 1930, which is produced herewith in response to subpena item No. 1.

Terms of the Memorandum for European Markets

The prime movers behind the memorandum were the same three international petroleum interests that formulated the Achnacarry agreement. Thus the memorandum neither abolished nor superseded the Achnacarry agreement, but rather reenacted its principles, with procedural amendments to cover their application in local marketing areas.[4] The keynote of the memorandum is contained in its first paragraph, which states that—

> Local arrangements will be made between the parties for each country and shall be of such duration as may be thought advisable.[5]

While the "local arrangements" were to concern primarily the Big Three, provision was made for the admission of others by the declaration that—

> It is the intention that all outside concerns seriously engaged in the distribution of petroleum products shall be admitted, provided that the conditions on which they are admitted are not more favorable than those enjoyed by the original parties at the time when they were admitted.[6]

Such admission of outsiders, however, could occur only "by the unanimous consent of the parties," i. e., the three initiating interests.

The products covered by the memorandum consisted of—

> * * * all products of petroleum with the exception of—
> (*a*) Specialties, including candles.
> (*b*) Bunkers, i. e., supplies to ships otherwise than supplies of oil made for the propulsion of trawlers, fishing boats, and similar small coasting vessels which usually bunker in their home ports, supplies which are regarded as internal trade of the country.[7]

This product coverage differed from the Achnacarry agreement only in that (1) lubricating oil was definitely included, whereas in the Achnacarry agreement lubricants were to be the subject of further consideration; and (2) the Achnacarry agreement did not specifically mention bunkers.

Quotas and maintenance of "as is" positions.—Quotas were to be allotted to each party for each of the products classed as part of the internal trade of each country. As in the case of the Achnacarry agreement, the base period for the determination of quotas was to be 1928.[8] The memorandum declared that—

[4] Under the new approach, production control became a matter for local action among the principal producers in each flush-producing area by the shutting in of production as described above.
[5] Memorandum for European Markets, clause I.
[6] Ibid., clause IIIa.
[7] Ibid., clause IV.
[8] This applied to all products except lubricating oils, for which the year ending June 30, 1929, was to be the base.

It is an essential part of these arrangements that each and every party thereto, having been allotted a quota, shall do his utmost to obtain the share of total trade represented by that quota, and to extend it where possible *but not at the expense of the parties to these arrangements.*[9]

The intent of this provision obviously was to place the responsibility on each party to put forth effort to maintain and increase its quota rather than to rely on the quota as a guaranty of a specified volume of business. However, the general rule to be followed was that members could expand their quotas *only at the expense of outsiders.* The rules were quite explicit on this point:

It is the duty of each party, to himself and to the other parties, to maintain at least the position in the market represented by his quota. If, notwithstanding this, there should be any change in the relative position of the parties, it can arise only: (i) if one or more of the parties has failed to do his quota by losing trade to an outsider; (ii) if one or more of the parties has improved upon his quota by gaining trade from an outsider; (iii) if any of the parties has gained trade from another party.

As the principle to be maintained is that what is gained from an outsider or lost to an outsider is entirely for the account of the party gaining or losing, it follows that no question of overtrading or undertrading arises in the case of (i) and (ii) but in the case of (iii) only, the party gaining is an overtrader and must adjust with the undertrader.[10]

Rules for the adjustment of "overtrading" and "undertrading" were spelled out in detail. The preferred method was to make such adjustments by transfer of customers among the parties, which might take place at any time during the trading year.

If adjustments could not be made in this manner, the undertrader was to receive from the overtrader at the end of each trading year the "net proceeds" realized by the overtrader for the quantity of each product overtraded.[11]

To further guard against any party becoming a habitual undertrader by default of effort to sell, it was provided that, as a penalty, the undertrader's allotted quota for the ensuing year—

* * * shall be reduced by a percentage equal to one-quarter of the difference between his allotted quota for the year and the actual percentage of the total trade which he has done during the year, and the reduction so made in the quota of the undertrader shall be divided between the other parties, being overtraders, pro rata to the amount of their overtrading.[12]

If the "as is" position of all parties, based on their 1928 quotas, was to be maintained, it was important that no party should obtain and hold a heavy overtrader position at the expense of the other parties. Therefore, provision was made for a sliding-scale system of penalties for overtrading, to be collected and distributed to undertraders in the following manner:

There shall be no penalty on an overtrader provided his overtrading does not exceed his allotted quota for the year by more than 5 percent of such allotted quota. If, however, a party is an overtrader to the extent of more than 5 percent in excess of his allotted quota, then in respect of the quantity represented by the initial 1 percent in excess of 5 percent he shall pay a fine and for the quantity

[9] Memorandum for European Markets, clause III. [Italics added].
[10] Ibid., clause VIII.
[11] "Net proceeds" for this purpose were defined as follows:
"* * * the net proceeds realized [by the overtrader] after deducting expenses, which shall include an allowance to be agreed upon for overheads and amortization. The proceeds for this purpose shall be the average proceeds realized for the grade in question by the overtrader during the period for which the adjustment is being made.
[12] Memorandum for European Markets, clause X.

represented by the next completed 1 percent of the basic amount, the fine in respect of the excess quantity shall be increased by a surcharge of 20 percent of the basic fine, and in respect to the quantity represented by each subsequent completed 1 percent the surcharge shall be increased by a further 20 percent of the basic fine: provided, always, that in no case can the surcharge be more than 100 percent in excess of the basic fine. The amount paid in fines and surcharges shall be apportioned among the undertraders pro rata to the amount in tons or gallons as the case may be of their undertrading.[13]

The amount of the basic fine was to be fixed for each product by the local representatives of the parties in each country, subject to approval.[14]

As a guide to the local representatives, however, it was stated—

that the fine should be such as will reasonably dissuade any party from setting *any extravagant pace* in organization or advertisement.[15]

Provisions were also incorporated which would make the heavy overtrader who gained at the expense of the other parties, as distinguished from outsiders, pay out in adjustments and penalties the whole of the proceeds from his overtraded sales in excess of 10 percent of his quota.[16]

Prices and conditions of sale.—The memorandum provided that each local cartel would fix the prices and selling conditions for all of its parties for each product sold in the market. The pricing activities were related to the maintenance of the "as is" position of the parties by the provision that—

It is agreed between the parties that they shall maintain at least the share of the total trade which they held during the basic period, and to this end prices and selling conditions *shall be fully and frankly discussed and agreed* between the local representatives. In the event of disagreement between the parties the matter shall be settled by a simple majority vote, each party having one vote for each complete 1 percent of quota.[17]

The parties were bound to observe prices so determined as long as they jointly maintained at least 90 percent of the share of the market which they jointly held during the basic period, plus a similar proportion of the market's increased trade. If, however, the joint shares of the parties fell below 90 percent, "then all the parties are free to take whatever action they may deem necessary to restore their joint share of the total trade of the market to the percentage at which it stood during the basic period."

Since the loss of large contracts to outsiders would practically nullify efforts to maintain the joint "as is" position of the parties, the pricing and handling of such contracts were made the subject of special provisions. It was agreed that, in principle, the party:

holding the business in the basic period shall retain it, but in any case prices and conditions for all such business *shall be discussed between the parties, and in the event of the party who, it has been agreed,* shall take the business, losing it to an outsider after quoting prices and conditions on which all are agreed, all the parties

[13] Ibid., clause XI.
[14] Approval by whom was not stated. It would appear from the Swedish Oil Report, however, that at a later date the Swedish cartel operated subject to approval by a committee in London representing the three principal parties. See Swedish Oil Report, ch. 12, Cartels and Other Competition Limiting Measures, pp. 14 and 25. (English translation mimeographed.)
[15] Memorandum for European Markets, clause XI. [Italics added.]
[16] It was suggested that the amount of the basic fine should be one-half of the allowance for overhead and amortization which the overtrader would, by agreement, withhold in making quota adjustments with undertraders. On this basis, the maximum basic fine plus surcharges would increase with the amount of overtrades and finally become equal to the whole of the allowance for overheads and amortization withheld in adjusting overtrades.
[17] Memorandum for European Markets, clause XIII. [Italics added.]

> shall, without alteration of their quota rights, take their share of the quantity lost pro rata to their respective quotas. But if, on the other hand, the party whose business it was to make the contract fails to quote the price and conditions which have been agreed with the other parties, and thereby loses the contract, he will have no claim to share the loss with the other parties * * *.[18]

If, however, there was disagreement among the parties and the party whose business it was to make the contract declined:

> to quote the price proposed by a majority vote * * * then the parties who have composed the majority vote in favor of a lower price shall arrange between themselves to quote for the business at the price which they have proposed. In the event of their obtaining the business the quantity involved shall not be included in their trade for purposes of arriving at their overtrading or undertrading positions. * * * If, on the other hand, the contract should be lost, then all the parties shall share in the loss in exactly the same way as if the contract had been lost after an agreed price had been quoted.[19]

It will be noted that action was to be taken by majority vote, and not by unanimous consent such as frustrated price actions by the Export Petroleum Association.

However, the voting power of each participant was to be proportional to its basic "as is" quota in the market. This, of course, gave the participants with large quotas the dominant voting power to determine the prices which all participants agreed to observe. It was recognized that dissatisfaction might arise on this score, even among the three largest companies, and that the opportunity for disagreement would increase with the admission of other parties. Such disagreements, however, were not to be permitted to upset the local cartel as long as the group maintained at least 90 percent of its joint share of the market during the base period.[20]

Only if an all-out price war with independents was deemed necessary to maintain the joint quota position was the majority-vote pricing rule permitted to lapse. In that case, all parties were to be free to take whatever price action they individually might regard as necessary to restore their position. Such a temporary suspension of the pricing rule meant a practical suspension of at least part of the cartel's operations for as long as the resulting price war might last. During such a suspension, however, it would appear that the meetings of local representatives of cartel members to exchange statistics of their own trading and estimates of trading by others, and to "cooperate to the fullest extent to get the best results and make the best possible use of the information obtained," were to continue. Full cooperation could be reestablished when the joint quota position of the group was reestablished.

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[18] Ibid., clause XII. [Italics added.]

[19] Ibid. In the case of low prices made to hold large contracts provision was made for the cartel member entitled to take the business to decline to bid the cartel price fixed by majority vote, in which case the remaining cartel members would arrange among themselves to quote the low price. If they obtained the contract, the group's joint quota in the market would be retained, subject to adjustment for over-and-under-trading as provided in the memorandum. To prevent this rule from giving undue protection to the member refusing to quote, it was provided that business so taken would not be counted in arriving at the over- and under-trading positions of the parties who took the business, but would be counted in computing the average net price per unit on which adjustments for over-trading and under-trading positions were to be made within the group at the end of the year. The financial loss, both to those who took the business, and to the member who declined to bid, thus would be minimized in setting bona fide over-trades and under-trades.

[20] Several contingencies might make joint maintenance of 90 percent of the quota impossible in competition with outsiders. If the cartel's monopoly price was fixed high enough to be satisfactory to all participants, it might be undercut by an outsider favorably situated with respect to costs or willing to dump in the market regardless of cost. If, on the other hand it was fixed low enough to meet or drive out lower independent price competition, the cartel's majority-price action might mean a price war in which some cartel members might wish to withdraw from the market. The problem, therefore, was how to cover this last contingency in such a way as to suspend cartel operations in whole or in part for a time without entirely disrupting the organization.

Management of local cartels.—The local cartel arrangements for each country were to be made "between the parties for each country." At the outset these parties were three in number,[21] as evidenced by a statement contained in an addendum to the memorandum that "* * * it is understood between the three parties concerned that the main principle is of durable nature." It was further stated in the addendum that "outside the scope of anything which may be incorporated in local arrangements, the parties undertake as between one another" to carry out certain commitments, one of which was that:

> * * * It is agreed that approval of any proposal to admit outsiders to a local arrangement shall be given by the unanimous consent of the parties.[22]

Thus, although price actions could be taken on the basis of majority vote, the question of including new members required unanimous consent.

The active management and operation of each local cartel was delegated largely to the local representatives. The principal duties of the local representatives were: (1) To establish quotas for the base year and for subsequent years; (2) to fix prices and terms of sale;[23] (3) to meet at least every 2 weeks to exchange statistics respecting their own trade and estimates of the trade done by outsiders;[24] (4) to adjust and maintain quotas of members by exchanging customers or by exchanges of products among members;[25] (5) to fix fines for overtrading and to apportion fines so collected among undertraders;[26] and, (6) through their biweekly meetings to "* * * cooperate to the fullest extent to get the best results and make the best possible use of the information obtained, not only in the matter of their position in relation to one another but also of their position in the market as a whole."[24]

Other provisions.—In a second part of the memorandum, bearing the same date as the main memorandum, the parties agreed, for all European countries, not to give makers of petroleum-consuming apparatus any commission or bonus for recommending the use of their products. It was also agreed not to take any secret financial interest in concerns making or using[27] petroleum-consuming apparatus.[28]

A third part of the memorandum, bearing the subtitle "Addendum to Memorandum for European Markets," and likewise dated January 20, 1930, covered two points. The first was the provision described above, requiring unanimous consent of the Big Three to the admission of outsiders to local agreements. The second dealt with the subject of acquisition of independent local distributing concerns by any of the three principal parties. In such an event, the purchaser agreed to offer a pro rata participation to the other parties. If any

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[21] These were local marketing subsidiaries of Anglo Iranian, Royal Dutch-Shell and Standard (New Jersey).
[22] Addendum to memorandum for European markets.
[23] Memorandum for European markets, clause V.
[24] Ibid., clause VII.
[25] Ibid., clause IX.
[26] Ibid., clause X.
[27] For the purpose of distinguishing between makers and users of petroleum apparatus, the following definition was given: "For the purposes of the foregoing, makers of petroleum-consuming apparatus are manufacturers of oil burners, lamps, stoves, oil engines, motor vehicles, motor vessels, steamships, and airplanes, while users of petroleum-consuming apparatus are taxicabs, motor-transport services, aviation services, aerodromes, and garages."
[28] This provision, however, was not intended to prohibit 100-percent ownership of petroleum-apparatus concerns, provided the ownership was disclosed to the other parties; nor was it to prevent any party from taking an interest in such firms "if such a step is necessary to prevent a trade outlet from going to an outsider," and provided, also, that the acquisition was disclosed to all other parties, if possible, before it actually was made. Memorandum No. II for European Markets, January 20, 1930.

of the other parties refused to join in the purchase, the remaining parties were to have the right to make the purchase jointly and add the trade thereby gained to their quotas. These joint-ownership provisions, however, were not to apply if the initial purchasing party—

> * * * has in the market in question no direct or indirect shares in the distributing trade in which the purchasing concern is engaged; provided always that the other parties are informed and the purchaser does not displace the source of supply of any party who is a party to the main agreement in respect of the country in question.[29]

The general purpose of the entire memorandum was succinctly described in the addendum in the following words:

> As there are many European countries which are now endeavoring to work out certain agreements, it is desirable to give a sketch of the charter which will fix the *main principles* for all European countries.[30]

These "main principles" were based on the "as is" concept of the Achnacarry agreement. It was this fundamental concept which governed the detailed procedural rules laid down to cover allocations of quotas, admission of outsiders, transfer of customers, and adjustment of overtrading and undertrading, penalties for overtrading, limitation of the acquisition of financial interests in petroleum consuming and using concerns, and provision for pro rata shares in the purchase of independent distribution outlets.

Operations under the memorandum.—The Memorandum for European Markets, dated January 20, 1930, continued to be the "charter which will fix the main principles for all European countries" until a new convention, known as the Heads of Agreement for Distribution, was adopted on December 15, 1932.

Trade press reports indicate that prior to the formulation of the memorandum, Royal Dutch-Shell and Standard Oil of New York were engaged in price competition in the East Indies and Asia that was reported to have "occasioned heavy loss to the Shell interests." Foreign comment indicates that this competition in distribution markets was terminated by agreement in May 1930, whereupon both companies increased their prices. More specifically as to what happened in this settlement, The Petroleum Times reported that—

> By means of personal negotiations with the Standard Oil interests, Sir H. Deterding has succeeded in reaching agreement with them, not only in the sphere of production, but also for cooperation in refining and distribution.[31]

The United States Tariff Commission reported early in 1931 that in addition to the proposal by Royal Dutch-Shell that Venezuelan production be reduced in proportion to reduction made in United States production in 1929, Standard Oil Co. of Indiana proposed in September 1930 that Venezuelan production be curtailed 9 percent beginning October 1, 1930.[32] The Petroleum Times described this proposal as having been made to Creole Petroleum Corp., Gulf Oil Corp., and Royal Dutch-Shell interests in Venezuela.[33] These reductions appear to have been carried forward into the ensuing year, as it was reported that Venezuelan production for the first half of 1931 was 14 percent below that of the corresponding period of 1930.[34]

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[29] Addendum to Memorandum for European Markets, par. (1).
[30] Ibid., introductory paragraph. [Italics added.]
[31] The Petroleum Times, September 6, 1930, p. 374.
[32] U. S. Tariff Commission, Cost of Crude Petroleum, 71st Cong., 3d ses., Doc. 267, Jan. 26, 1931 20.
[33] The Petroleum Times, October 25, 1930, p. 662.
[34] Ibid., August 1, 1931, p. 137.

New distribution agreements under the memorandum.—After resolving their internal differences, the parties to the memorandum began to actively apply its principles in various European countries. Among the countries where local agreements were formulated were Germany, where similar agreements had been attempted in previous years,[35] Austria and Switzerland, where motor-fuel cartels, which had been dissolved for a short time, were reported in September 1930 as being reconstituted; and Poland, where a naphtha cartel was reformed, also in 1930.[36] Negotiations were also undertaken for a revival of a Spanish petroleum monopoly, concerning which it was reported—

> The Standard Oil and Shell interests are in opposition to the Russians, and may obtain an increased share of the supply business on the basis of supporting the exchange value of the peseta.[37]

Spain was only one of a number of countries in which Russian competition was troublesome. Where Russian interests were involved, it was usually necessary to carry on negotiations on a political as well as on an economic level. In general, the Russian trading interests adopted an attitude of aloofness toward binding agreements. At the same time, however, they cooperated in certain local markets where they considered it to their advantage not to undercut the cartel price structure. In markets where they wished to expand foreign outlets, they competed actively.

The Rumanian agreements

During the thirties Rumania was Europe's principal oil-producing country operating under private ownership. Hence, the local marketing agreements which were developed under the memorandum for European markets and the measures concurrently taken to control production and distribution of Rumanian oil are of particular importance.

Early in December 1929, while the memorandum for European markets was being negotiated, it was announced that, after months of discussion, practically all of the Rumanian operators had signed a new production agreement,[38] which would bring the Rumanian operators "into line with the rest of the world." In parts of Rumania, prices were promptly increased some 10 percent.[39]

In July 1930, further details of the plan were announced; Astra Romana, a subsidiary of Royal Dutch-Shell, and Romano Americana, a subsidiary of Standard Oil Co. (New Jersey), proposed to purchase from all Rumanian producers the same quantities that they had purchased during the preceding year at prices based on American Gulf quotations.[40] At this time Export Petroleum Association was still operating as the American export agency which determined the Gulf export prices. The Rumanian producers were to be allotted quotas which were to be rearranged periodically in accordance with variation in exports and internal consumption.[41]

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[35] Ibid., September 13, 1930, pp. 429–430.
[36] Ibid., September 6, 1930, p. 374.
[37] Ibid. For further information regarding some of the above-mentioned cartels and other cartels established under the memorandum, see ch. IX.
[38] The formation of this agreement followed by several months the modification of the Rumanian mining law legalizing a cartel which had existed unlawfully in Rumania during the previous year. This earlier cartel had included only the big international producers who were operating in Rumania and, therefore, had not been fully effective in its coverage of Rumanian production.
[39] The Petroleum Times, December 7, 1939, p. 1112.
[40] Ibid., July 19, 1930, p. 85.
[41] Ibid., Aug. 12, 1930, p. 178.

In the fall of 1930, this plan suffered a set-back due partly to the discontinuance of Gulf price quotations by the Petroleum Export Association and partly to the failure of Rumanian proration efforts. On October 24, 1930, it was announced that Steaua Romana, an important Rumanian producer, had given notice of withdrawal from the commission for restricting oil production in Rumania and would resign from the proration scheme effective November 30, 1930.[42]

Negotiations for the reestablishment of the Rumanian cartel got under way almost immediately. It was reported in May 1931 that, through negotiations which Sir Henri W. A. Deterding was able to conduct during a visit to Bucharest—

> Refiners were pleased and signed the agreement and higher prices were assured. The price of motor spirit has already risen in Bucharest 2 lei per kilo, and the prospects for a further increase almost immediately are predicted.[43]

The success of this new Rumanian agreement hinged upon the general control of world crude-oil production.[44] To achieve such control, the Rumanian producers suggested that an international conference be held. J. B. Aug. Kessler, of Royal Dutch-Shell, advanced a plan for a conference on conservation. In November 1931, it was reported that the Rumanian Association of Petroleum Industrialists was prepared to send representatives to such a conference to "assist in working out the most adequate means for the establishment of a world agreement between oil-producing countries on the principles laid down by Mr. Kessler." [45]

This information was communicated to the American Petroleum Institute, with the suggestion that the institute take the lead. The institute promptly indicated its willingness to call a meeting in New York, but stated that, because of United States antitrust laws, it could not "accept the Kessler plan as a basis for discussion, nor any other plan involving a definite agreement among producers to restrict production." [46]

The Rumanian Association of Petroleum Industrialists thereupon asked the American Petroleum Institute to suggest an alternative to the Kessler plan, and the institute is reported to have replied:

> Proposals are being made to our Congress which, if enacted, might clear the way for definite and binding action on the part of our Government and industrialists. We therefore suggest that the call of conference be deferred pending action on our proposals. We repeat our assurance of sympathetic attitude and await your advices.[47]

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[42] Ibid., Nov. 1, 1930, p. 688. Steaua Romana was owned by British-French-Rumanian interests (International Petroleum Trade, Feb. 28, 1941, p. 69). According to Moody's Industrials, 1938, the British interest was held by Anglo-Iranian.

[43] Ibid., vol. 25, 1931, p. 733.

[44] Some hope of such control was aroused in the European trade by the announcement early in August 1931 that Venezuelan crude production during the first 6 months of the year was 14 percent less than during the corresponding period of 1930 (The Petroleum Times, August 1, 1931, p. 137).

[45] Ibid., November 7, 1931, p. 594.

[46] Ibid., November 21, 1931, p. 662.

[47] Ibid., February 6, 1932, p. 140. Following this, companion bills authorizing an interstate oil compact in the United States, as proposed by the Oil States Advisory Committee, were introduced in both Houses of the Congress in March 1932. These bills were, respectively, S. 4232 March 23, 1932, and H. R. 10863, March 26, 1932. Both were entitled "For the conservation of oil and gas and the protection of American sources thereof from injury, correlation of domestic and foreign production, and consenting to an interstate compact for such purposes." These bills were referred, respectively, to the Senate and House Committees on the Judiciary. No further action was taken at that time on either bill (Congressional Record Index, vol. 75, pt. 15, pp. 747 and 965.)

In July 1932, an international conference was finally held in Paris, at the conclusion of which it was announced that an agreement concerning the Rumanian oil problem had been reached:

> * * * between the representatives of the Rumanian groups and those of the international group on the essential points destined to improve the situation in the import markets. Stabilization will be attained by a *reciprocal undertaking to respect the relative positions of the exportations of the two groups.*[48]

Again, it is interesting to note that the controlling principle was to be that of the Achnacarry agreement, maintaining relative positions. Final ratification by the Rumanian producers was delayed until September 1932, at which time it was stated that the chief object of the agreement was that—

> * * * Rumanian oil should be directed with the greatest promptness toward the controlled distributing organizations who were agreed to adhere to the convention for quotas and prices in consuming countries.[49]

In these negotiations the international group first proposed that the Rumanian quota should be based on sales for the 1928 calendar year (the Achnacarry agreement base year). In order to obtain Rumanian adherence, however, it was agreed "after long discussions" that the basis for quotas should be Rumanian exports between July 1, 1931, and June 30, 1932. This change in the base period gave the Rumanians an increase of 65 percent. The international group also agreed to continue buying as much Rumanian oil as they had purchased during the base period.[50] On their part, the Rumanians agreed to adhere to the quotas and price agreements set up under the Memorandum for European Markets, and to base their prices for sales to the international group "on those ruling at the Gulf."

The consuming markets to which the Rumanian agreement was to apply were—

> Europe (excluding Rumania), Turkey in Asia, Syria, Palestine, Egypt, Sudan, Tripoli, Algeria, Tunis, French Morocco, and Spain.[51]

The fall of 1932 was consumed in conferences in Rumania and Paris working out operating details of the agreement. In October it was reported that the Paris agreement had been altered to provide for arbitration by a "mixed commission"[52] in case the Rumanians were unable, because of circumstances beyond their control, to fulfill their rights and obligations "in any country whatever." It was specifically provided that if the Rumanian group was unable to maintain its "as is" position in any country due to the export activities of "any exporter from America who is not a member of the international group," it would be the duty of the mixed commission to attempt to

[48] The Petroleum Times, July 30, 1932, p. 106. [Italics added.]
[49] Ibid., August 27, 1932, pp. 195–196.
[50] By bargaining for an "as is" position based on the later year, the Rumanians increased their base year total export quotas for all petroleum products from 2,822,900 tons for the year 1929 proposed by the international group to 4,667,860 tons for the year 1931 finally agreed upon. The purchases of the international group were stated to represent about 45 percent of Rumania's total exports during the base period.
[51] (The Petroleum Times, August 27, 1932, pp. 195–196.) In accordance with the Memorandum for European Markets, each of the parties to the Rumanian agreement had the right to expand its position in any of these countries by the acquisition of the businesses or the trade of "third parties which did not participate in the local agreement."
[52] This was a central committee consisting of representatives of the international group and the Rumanian group, set up under the Paris agreement.

find an adequate solution.[53] From the Rumanian viewpoint, an adequate solution apparently required that the mixed commission either bring the independent American exporters under control or make some other satisfactory provision by which the Rumanian position would be maintained regardless of the activities of the American independents. In other words, the price of Rumanian adherence was that others restrict their shipments in order to bolster prices for Rumania's increased production.

In the latter part of 1932, the whole agreement was threatened by the sharp decline in Gulf prices, which dropped materially below the price of oil in Constanza. Since the cartel's price structure was based on the Gulf price, a solution had to be found. A Petroleum Times editorial on the Outlook for 1933, took the position that United States producers would have to play the game; that there was too much price cutting in the United States, and that American producers would have to see that export prices conformed to those outside the United States.[54] On February 4, 1933, another Petroleum Times editorial stated that if the Roumanian agreement was to be continued, the international group "must raise the price in the United States." [55] A week later an editorial again commented that the Roumanians were taking a serious view of the situation; that the president of the Roumanian Association of Petroleum Industrialists had been in both London and Paris interviewing representatives of the international oil group; and that J. B. Aug. Kessler had gone to New York.[56]

The problems met in trying to establish a local agreement in Roumania illustrate the difficulties which plagued local marketing agreements which were established under the memorandum for European markets. As in the case of the Roumanian agreement, it was difficult, if not impossible, to maintain these other local agreements as long as world production was not effectively controlled. In other words, the existence of a fringe of uncontrolled producers proved to be just as troublesome in the early thirties to the new strategy of setting up local agreements as it had been to the previous effort to establish a comprehensive cartel.

Control of Russian oil—New York conference, May 1932

Although the American Petroleum Institute did not follow the Rumanian suggestion to call a world "conservation" meeting to consider the Kessler plan, it did call a conference held in New York which was attended by representatives of both American and European interests.[57] This meeting was described in the European trade press as preliminary to the proposed world oil conservation conference.[58]

[53] (The Petroleum Times, October 22, 1932, p. 415.) An editorial note pointed out that these modification, were "particularly interesting in the case where, by reason of the intervention of a noncontrolled competitors the groups can no longer effect the position to which the "as is" gives them the right."

[54] Ibid., January 7, 1933, pp. 15-16.

[55] Ibid., February 4, 1933, p. 118.

[56] Ibid., February 11, 1933, p. 129.

[57] The Petroleum News, May 7, 1932, p. 526, stated that those present from Europe would include: J. B. Aug. Kessler of Royal Dutch-Shell, William Fraser of Anglo-Persian; R. I. Watson of Burmah Oil Co., H. Von Riedemann, representing European interests of Standard Oil Co. (New Jersey), and Wilson Cross of Vacuum Oil Co., of London. It was also stated that three Russian representatives also were in New York, but not primarily for the conference.

[58] Although this meeting appears to have grown out of the Rumanian suggestion regarding a world conference, it does not appear that the Rumanian situation was given any attention except that the Russians "stressed the fact that Rumanian competition in European markets during the past few years has proved even more demoralizing than that by the Soviet."

The American trade press stated that American representation at the New York meeting was—

> necessarily confined to the major American exporting companies; that the European representatives were present at the invitation of Charles E. Arnott, president of Socony-Vacuum Oil Co., and that all present at the conference were pledged to secrecy.[59]

During the conference, which lasted about 3 weeks beginning in the middle of May 1932, it was stated that Messrs. Arnott and James A. Moffett, Jr., vice president of Standard Oil Co. (New Jersey), acted as joint spokesmen for the meeting but "continued to withhold definite news of the progress of the conference and the actual aims of the conferees." It was generally believed, however, that negotiations were being concentrated on an effort to arrange for the "orderly" marketing of Soviet refined products in world markets. This was to be accomplished through agreements under which the major international companies would buy stated quantities of Russian oil for distribution through their own marketing organizations. The only hitch was the inability of the Soviet representatives and the other interests to reach an amicable accord on the quantities to be so taken and the prices and terms of sale.[60]

It was further stated, but without official confirmation, that the American and European companies proposed to buy approximately 37,500,000 barrels of Russian oil annually for a period of 10 years, or approximately the quantity of Russian exports of refined products in 1931. Regarding the prices to be paid, it was stated that—

> Soviet Russia, obviously, would be unwilling to accept the f. o. b. Constanza price as a representative "free market," and it is believed that the United States Gulf will finally be decided upon as the representative "free market" on which a world quotation can be based.[61]

The early trade press reports forecast an agreement with the Russians, but announced a week later that the negotiations were deadlocked over the insistence of the Russians on (1) periodic increases in their quota and (2) the right to market their oil through their own foreign marketing organizations. When the other international interests refused to accept these conditions, the negotiations broke down altogether. Thereupon, Charles E. Arnott, of Standard Oil (New Jersey), and Philip Rabinovich, of the Soviet Commissariat for Foreign Trade, announced jointly that it had been impossible at that time to reach any mutually satisfactory agreement for the solution of the problems created by the lack of balance between production and consumption.[62] At the same time, however, it was indicated that further efforts to stabilize world markets would be continued through local agreements in particular countries. These efforts continued after the adoption, on December 15, 1932, of further understandings embodied in the memorandum known as the "Heads of Agreement for Distribution."

[59] The Oil and Gas Journal, May 26, 1932, p. 17, stated that: "Representatives of the major American companies participating in the world conference find themselves in an anomalous position * * *. Being unable to divulge the trend of the proceedings, because of the obvious danger of 'upsetting the apple cart' in the midst of negotiations through the misconstruction of the proceedings or an ill-timed criticism of the negotiations, they are subject to criticism by many elements in the industry for this very policy of secrecy which they deem so essential."

[60] Ibid. It was also stated that "* * * the arrival of the American and European oil companies at an accord with respect to the proposals to be submitted to the Soviet was in itself no small feat of diplomacy. Some of these interests in recent years have been at odds with their competitors regarding certain aspects of foreign marketing operations, and even should the Russian negotiations fall through * * * it is felt that the conference will have accomplished considerable constructive work through the bringing together of major European and American oil companies for an informal round table discussion of mutual problems and an ironing out of difficulties and misunderstandings hitherto existent."

[61] Ibid., p. 17.

[62] The Oil & Gas Journal, June 9, 1932, p. 100.

HEADS OF AGREEMENT FOR DISTRIBUTION, 1932

Origin and nature of the Heads of Agreement

Following the Rumanian agreement of 1932, there still remained the problem of fitting Rumanian export production into the local cartel quota and price agreements to which the Rumanian agreement applied. Some of these local agreements were carry-overs from the period before the adoption of the Memorandum for European Markets in 1930; some included parties other than those adhering to the "as is" principle; and some deviated in other respects from the principles and procedures laid down in the Achnacarry agreement and the Memorandum.[63] The "as is" leaders decided to continue such agreements until their termination, at which time new agreements would be made in accordance with the main international charter. To this end it was felt that a new set of rules restoring the principles and procedure of the Achnacarry agreement and the Memorandum for European Markets was needed as a guide to the local representatives in formulating the new local cartel arrangements. This intent was clearly set out in the first paragraph of the Heads of Agreement for Distribution, adopted December 15, 1932, which stated:

> The "Heads of Agreement" which follow have been drawn up with a view that they should be used as a guide to representatives on the field for drawing up rules for local cartels or for local Agreements. It is the intention that all such local Cartels or Agreements should be based on these "Heads" but in those countries where the parties have already or make in the future a satisfactory working arrangement or agreement, which includes "non-as-is" parties and which differs from the guiding principles laid down herein, it is not proposed that those agreements should be altered, if such alterations would cause undue disturbance; but if such local agreements should terminate for any reason, then those "as is" partners who continue to cooperate shall base their relationship each with the other on the lines of the provisions which follow.[64]

At the time the new agreement was formulated there were two "as is" committees known respectively as the New York and London "as is" committees. The new agreement was formulated by the London committee, which held a series of preliminary meetings in London on October 24 and 25 and November 17 and 18, 1932.

All of these preliminary meetings were covered by a single consolidated minute. The minutes of the final meetings of the London "as is" committee, at which the agreement was adopted on December 15 and 16, 1932, indicate that representatives of Socony-Vacuum, Standard Oil Co. (New Jersey), Anglo-Persian, Gulf, Atlantic, Texas, and Royal Dutch-Shell were present. A representative of Sinclair Oil Co. wired regretting his inability to be present. This appears to have been the roster of the London "as is" committee at that time.

At the first preliminary meeting, it was agreed that the Memorandum for European Markets should be considered clause by clause with a view to so revising it that "there would be one common basis governing the relations between all 'as is' parties." It was decided that two memoranda should be drawn up: one to cover distribution arrangements and the other to cover supply arrangements. These memoranda would then be presented for discussion and adoption at

[63] Deviating agreements were the result of making the best bargains possible in particular consuming countries with concerns that did not accept all of the principles laid down in the Achnacarry agreement and the Memorandum for European Markets. An instance was the agreement already mentioned between Russian Oil Products Co., Ltd., the Soviet marketing agency in Great Britain, and Anglo-American, Shell, and other important British marketing agencies. Numerous other agreements existed in other continental consuming markets.

[64] Preamble to the Heads of Agreement.

a meeting including representatives of all the "as is" companies. The draft of the Heads of Agreement for Distribution Memorandum was considered and amended at a meeting of the full London "as is" committee, and adopted on the following day. Whether any action was taken by the London committee to formulate the proposed second memorandum is not clear from the record. It is clear, however, that on December 15, 1932, the full London committee recommended that the supply problem be handled by the New York "as is" committee, which, along with the American Petroleum Institute, was actively promoting the conservation movement in the United States as a means of restricting American production and fitting it into world cartel objectives.[65]

General terms of Heads of Agreement

The following analysis of the terms of the Heads of Agreement for Distribution is based on a copy of the document and certain minutes of meetings of the committee that drafted it, both of which were furnished by the Standard Oil Co. (New Jersey) in response to subpena. Since the new agreement is essentially a recodification, with amendments, of the Memorandum for European Markets, some of the clauses of the predecessor agreement were carried over almost without change. Notable among these were (1) the "as is" principle, (2) the clause dealing with the making of local arrangements to fit local conditions in each country (except the United States of America), and (3) the provision that all petroleum products (except such specialties as wax and candles and large ship bunkers) were to be covered. In addition it was provided that, unless other local arrangements were made, any other products not derived from petroleum, such as benzol, alcohol, and other products, which are mixed with, or compete with, any petroleum product, were to be included within the scope of the agreements.[66]

The Texas Co. reserved its agreement to these inclusive provisions on the ground that it had not accepted the principle of "as is" for all products and for all countries. It was agreed, however, that the clause should stand as drafted, and that the reservation by the Texas Co. should be made outside the Heads of Agreement. Also, Socony-Vacuum Oil Co. wished it recorded that, although it favored the inclusion of lubricating oils, it wished to consider itself "free so far as lubricating oils only are concerned, should no satisfactory solution of the practical difficulties concerning that product be found." However, even though no such solution was found, "Socony" stated its willingness to cooperate to the fullest extent at all times with other "as is" members concerning prices and any other factors affecting market stability.[67]

Quotas.—Among the clauses carried over from the previous agreements was the provision for the parties to meet and report their own deliveries and estimates of total deliveries of outsiders as a basis for determining the total consumption of each local market area. To this

[65] The minutes of the London "as is" committee meeting on December 15 state that in order to avoid duplication of effort between the two committees "* * * it was suggested that roughly the division should be that New York should handle supply 'as is' " and that London, being in close contact with the markets, should deal with distribution "as is."

[66] In the case of bitumen emulsions, however, only the actual bitumen content was to be included. Lubricating oils and greases, while subject to the basic principles of the Heads of Agreement, were also to be subject to a special memorandum which would provide "for the detailed working arrangements and for the adjustment of over- and under-trading," and also deal with "nonmineral ingredients in lubricating oils and greases" for "as is" purposes.

[67] Minutes of the London "as is" committee, December 15, 1932.

were added provisions which in principle would exclude a party's own consumption figures and which would require independent auditor's certificates for the companies' own trade figures.[68]

Also carried forward was the provision for monthly meetings of the local representatives to exchange statistics and to cooperate to the fullest extent not only in regard to their individual position in relation to each other but also in regard to their combined position in relation to the market as a whole.[69]

Trade and quota adjustments and penalties.—Also carried over from the Memorandum for European Markets were the general conditions governing the responsibility of each party to maintain its percentage-quota position and the general rule for determining overtrading at the expense of other parties. Rules for carrying out these conditions, however, were made more explicit. For example, it was declared that the only basis for determining over- and under-trades would be the percentage of the trade done by the parties during each trading period, as shown by their records at the end of the period. Definite rules were also provided for determining when over-trading had occurred which, in accordance with the "as is" principle, was to be corrected by exchanging customers, giving cash compensation, and paying fines. Likewise, a definite rule was added for determining how much of an under-trader's volume was lost to parties to the agreement, as distinguished from that lost to outsiders.[70]

Undertraders were to have the option of supplying products to overtraders or of accepting cash compensation from the overtraders at the end of each annual trading period. Rules for determining the compensation to be paid by overtraders also were spelled out in somewhat greater detail than in the Memorandum for European Markets.[71]

Under the 1930 memorandum, adjustments in quotas and payment of fines for overtrading were to be made annually on the basis of the preceding year's trading. Under the 1932 Heads of Agreement, however, quota adjustments were to be made only after a party had undertraded (after including losses to and gains from outsiders) for

[68] Heads of Agreement for Distribution, clauses V and VI. Here, again, a reservation was made by the Texas Co. to the effect that it was not willing to have its figures audited by an independent auditor. All other parties agreed that such outside audit might not be required of "as is" parties, but in view of the fact that the scope of "as is" was widening and that compulsory audits had been found "absolutely essential for the working of the French cartels in which a large number of small concerns was included," it was considered necessary to retain the clause as drafted. Minutes, London "as is" committee, December 15, 1932.

[69] Heads of Agreement for Distribution, clause VII. In addition, it was specifically provided that only the principal local representatives, defined as "only the senior representatives of each party for the market in question, or the next senior person as delegated by him to act in his absence" would be eligible to sit in such meetings.

[70] Heads of Agreement, clauses VIII and IX.

The rules for determining under- and over-trades were as follows: "If the figures at the end of the period are such that the overtraders' actual trade exceeds their allotted quotas to a greater extent than the undertrader's (or undertraders') trade is below his (or their) allotted quota, then the undertrade shall be assumed to have been gained by each overtrader pro rata to the volume of their respective overtrading, and the adjustment of trade, compensation, or fines which each overtrader must effect * * * shall be calculated on this basis.

"Again if the figures at the end of the period are such that the undertraders' actual trade is below their allotted quotas to a greater extent than the overtrador's (or overtraders') actual trade exceeds their allotted quota, then the overtraders' overtrade shall be assumed to have been gained at the expense of each undertrader pro rata to the volume of their respective undertrading, and the trade adjustment or compensation which each undertrader shall receive from the overtraders, and the quota adjustment (if any) which the undertrader shall suffer, shall be calculated on this basis."

[71] The average "gross proceeds of *all parties* for all invoiced deliveries for the product in question" during the trading period were to be substituted for *"the average proceeds realized * * * by the overtrader,"* as provided in the memorandum. Deduction from this average gross realization of a figure covering marketing expense, agreed upon by all parties before the beginning of each trading year, yielded the average cash compensation per unit of product which overtraders would pay to undertraders. To provide against the contingency that overtraders might benefit financially through reduction of their fixed expenses as a result of increased volume gained by overtrading, it was provided that the deductible marketing expenses should not include any allowance for depreciation, interest or overheads; in other words, should include only actual out-of-pocket expenses and commissions paid.

two consecutive years.[72] Detailed examples were given of how to compute the quantities to be deducted from the undertraders' quota and added to the quotas of overtraders at the end of any such 2-year period.

A similar substitution of a 2-year period for overtrading was made for the purpose of computing the fines which were to be paid by an overtrader and apportioned to undertraders. Again, detailed examples were worked out to illustrate the determination of the quantity a member had overtraded in each year, and the quantity on which he would pay a fine. As in the 1930 agreement, the fine was to increase progressively with each 1 percent overtraded in excess of an allowable margin of 5 percent.[73] The number of steps by which the fine would increase with each 1 percent overtraded in excess of 5 percent was reduced from 5 to 4, so that the percentage of overtrades at which the fine would become equal to the total deductible marketing expense retained by the overtrader was reduced from 10 percent to 9 percent.

As in the case of the 1930 memorandum, the Heads of Agreement treated large contracts as something in which the member holding them had a property right which it was the duty of other members to respect. It was therefore agreed that the local representatives of "the parties should discuss, inter se, selling conditions with a view to enabling the party holding the contract to retain it if possible." It was further suggested that large contracts offered a useful vehicle for making current trade adjustments in accordance with the rules for adjusting under- and over-trading.[74]

Admitting outsiders.—Both the Memorandum for European Markets and the Heads of Agreement declared that "it is the intention that all outside concerns seriously engaged in the distribution of petroleum products shall be admitted." In 1930, outsiders were to be admitted on conditions "not more favorable than those enjoyed by the original parties at the time when they were admitted." [75] This last provision had been rendered impracticable, however, by the recently formulated Rumanian Production Agreement, in which Rumanian producers were conceded a 65 percent increase in crude oil production over what they would have been entitled to under quotas based on their per-

[72] The provisions respecting adjustment of quotas were as follows:

"When, for each of two consecutive years a party has undertraded (after excluding losses to and gains from outsiders) by more than a margin of 5 percent of his effective percentage quota in each year his percentage quota for the ensuing year shall be reduced by one quarter of the amount by which his undertrading in the second year exceeds his 5 percent margin.

"The figure by which the undertrader's quota is thus reduced shall be added to the quotas of those parties who are not undertraders in excess of their 5 percent margin, pro rata to their respective quotas." Heads of Agreement for Distribution, clause XII.

[73] The provisions respecting fines were as follows:

"The overtrader shall suffer a fine if his overtrade for any product for each year of any two consecutive years is in excess of 5 percent of his allotted percentage quota for that year and for that product.

"In the above event the overtrader shall pay a fine for each unit of the quantity by which his overtrade in the second year of the 2 years is in excess of 5 percent of his allotted quota. The fine for each unit of this quantity represented by the initial 1 percent of his allotted quota, or fraction of that 1 percent, in excess of 5 percent overtrade, shall be 25 percent of the average marketing expense of the product for the second year, as agreed in advance under the provision of clause X. The fine for each unit of the quantity representing the second and third completed 1 percent or fraction thereof, in excess of 5 percent overtrade shall be 50 and 75 percent, respectively of the agreed average marketing expense, and for each unit of the quantity represented by the fourth and each succeeding 1 percent, or fraction thereof, the fine shall be equal to 100 percent of the agreed average marketing expense.

"The amount paid in fines by the overtrader shall be apportioned among the parties who are not overtraders, in excess of their 5 percent margin, in proportion to their respective quotas." Heads of Agreement for Distribution, clause XIII.

[74] Heads of Agreement for Distribution, clause XIV.

This brief general statement was substituted for the more detailed provisions of the Memorandum for European Markets respecting the fixing of prices and terms of sale for such contracts, and for cooperation to retain them within the member group.

[75] Memorandum for European Markets, clause III-a.

formance during 1928. In order to provide the elasticity needed to make room for Rumanian exports, the phraseology of the 1930 agreement was modified to permit the admittance of outsiders "provided that the conditions on which they are admitted are mutually acceptable to all existing partners." It was also agreed in principle that, to be admitted, outside concerns would be required to "accept the provision of these Heads of Agreement for all products and for all countries (except the United States of America)." [76]

In effect, this change in phraseology permitted new members to be admitted with percentage quotas computed on bases other than their trading during the base period. Such admission would require contributions from the quotas of existing members to make up the larger quota of the new member. How to handle this troublesome subject was considered by the London "as is" committee both in drafting the Heads of Agreement and again at the time it was adopted. The minutes of the committee indicate that no general agreement, however, could be obtained regarding a specific formula, although it was agreed within the committee that adjustments should be made in accordance with the following principles:

1. That all "as is" parties should contribute to the quota of any new member admitted with a quota larger than a share of trade held by him prior to admission.
2. That any new member so admitted would not be allowed to further increase his quota after admission by taking trade from outsiders until the old members regained their shares of trade represented by their quotas prior to the admission of the new member.[77]

In adopting the Heads of Agreement without a specific formula for sharing quotas with new members, the London committee stated in its minutes that—

So far as the future admission of new members was concerned, it was agreed that each case would be considered on its merits and it was hoped that a basis for adjustment would be found which would be mutually acceptable to "as is" members.[78]

Purchase of outsiders.—The acquisition of outside distribution outlets received careful consideration during the drafting and adoption of the Heads of Agreement. On December 15, 1932, the London committee directed that the following paragraph be included as a footnote to the clause dealing with the admission of new members:

Purchase of outsiders.—It is recognized that it is desirable to convert uncontrolled outlets into the controlled class; in view of this *the purchase by the "as is" members of going distributing concerns outside "as is" is to be recommended* as tending to improve the stability of the markets.

The purchase of such outsiders is in principle the equivalent of admitting new members to "as is" and should be treated accordingly. It is therefore recommended that where possible, such purchases shall be frankly discussed between parties interested before the purchase is completed.[79]

Virginal markets.—This was a new subject considered in adopting the Heads of Agreement. During the drafting period, the London

[76] Heads of Agreement for Distribution, clause III.
[77] Minutes of meetings held on October 23, 25, and 26 and November 17 and 18, 1932.
[78] Minutes of London "as is" committee meeting, December 15, 1932.
[79] Heads of Agreement for Distribution, footnote in connection with clause III. [Italics added.] This language was inserted in lieu of the more specific phraseology of the Memorandum for European Markets which had provided that any party purchasing a local outside distributing concern would offer a pro rata participation in the purchase to the other parties who, if they joined in the purchase, would divide the tonnage of the acquired outlet pro rata to the quotas of the participating parties in the markets concerned. Joint purchases, or any other solution satisfactory to the parties, could still be worked out through discussion among the interested parties.

committee defined virginal markets as "markets in which *no party to 'as is' arrangements had had trade for a certain product during the basic periods discussed.*" [80] No specific clause respecting such markets, however, was included in the Heads of Agreement. Therefore, the decisions arrived at by the committee regarding these markets appear to be supplemental understandings arrived at among the top executives of the parties as to how they would bring their operations in virginal markets within the scope of "as is."

The committee agreed in principle that all "as is" parties were entitled to a share of the trade for the product in question. Two suggestions were considered for determining the percentage share to which a party would be entitled if he entered a market where he had not hitherto traded. The first was that the parties should be entitled to percentage shares in the new market in the ratio of their respective shares of total world consumption (excluding the United States). The second was that the world market should be divided into areas or zones, and that the rights of the parties in a virginal market should then be in the ratio of their respective zonal percentages in the zone in which the particular market was situated.[81]

When this matter came before the London "as is" committee on December 16, 1932, the zonal basis was adopted. The minutes of the committee indicate that the following zones were suggested:

Zone

1. Europe, north African Mediterranean countries (Morocco, Algiers, Tunis, Tripolitania, Egypt), Near East (Palestine, Syria, Asiatic Turkey, Arabia, Persia, Iraq, and Red Sea area).
2. Remainder of Africa not included in 1, and neighboring islands (i. e., Madagascar, Seychelles, etc.).
3. Remainder of Asia not included in 1, Japan, Philippines, and East Indies.
4. Australasia, including Pacific islands.
5. South America, Central America, and West Indies.

There still remained, however, those cases in which a market might be "virginal" to some "as is" parties, but already occupied by others. Discussion of this subject immediately brought out the comment that under "as is" any party who was already in the market should be entitled to retain at least the quantity he was already selling therein. This meant that the second party entering the market was entitled only to such share as he might be able to take from outsiders, plus any increase in total volume sold in the market. In other words, the second "as is" party was entitled to his full "as is" quota in the market only if and when the total quantity sold in the market had increased sufficiently to cover his quota without encroaching upon the quantity which the first party had held before the second party entered the market.

Central "as is" secretariat

Prior to 1932, two international committees, the London "as is" committee and the New York "as is" committee, had operated to carry out the "as is" principles. These committees appear to have operated practically on a coordinate basis. With the adoption of the Heads

[80] Minutes of meetings held on October 24, 25, and 26 and November 17 and 18, 1932. [Italics added.]
[81] Ibid.

of Agreement for Distribution, new operating problems arose, particularly in connection with the admission of new parties. In order to deal with these operating problems, the minutes of the London "as is" committee of December 15, 1932, record that—

> all were agreed that to further the smooth working of "as is", it was full time that a central "as is" secretariat was formed, which was to be domiciled in London and which would be available equally to all members of "as is".

It was further agreed that the powers of the secretariat should be administrative and not executive, that its primary duties would be to serve as an aid to the "as is" committee,[82] and that its cost would be shared by all "as is" parties. The likelihood that the Rumanian agreement would soon become effective was cited as further reason for the formation of the secretariat. In regard to the division of executive functions it was suggested—

> that New York should handle supply "as is", and that London, being in closer contact with the markets, should deal with distribution "as is".

That the two committees were to continue to function coordinately was indicated by a statement to the effect that all decisions by the London committee affecting major issues and matters of principle would have to be referred to the New York committee before becoming effective, and vice versa. The duties of the central "as is" secretariat were to serve as a central service agency collecting and maintaining the necessary statistical data for the administration of "as is", and to record and circulate all decisions made by the two main executive committees. This was to provide working machinery in the fields of both production and distribution, with a central coordinating agency between the two executive committees. Thus the New York committee was to continue to promote the restriction of production, particularly in the United States, under the conservation program, while the London committee was to continue to supervise and coordinate the structure of world cartel controls, including local market agreements, and each committee was to clear its decisions with the other.

Additions to previous agreements.—The principal additions made by the Heads of Agreement to previous international understandings were to make it clear: (*a*) That the principle of "as is" was to apply in each and every country or area of the world except the United States; (*b*) that it was to apply to both "supply" (i. e., production and exports of crude oil and refined products) and distribution; (*c*) that supply "as is" would be handled by the New York "as is" committee; (*d*) that distribution "as is" would be handled by the London "as is" committee; (*e*) that the activities of these main working committees would be coordinated through a central "as is" secretariat; and, (*f*) that all disputes arising under the Heads of Agreement would be decided by a central "as is" committee, which also would

[82] The language used in referring to the "as is" executive machinery is somewhat confusing, sometimes indicating the existence of a single "as is" committee, while at other times specifically referring to separate performance of particular functions by the London "as is" committee, or the New York "as is" committee. The confusion may arise out of the fact that in the formulation of policy the two committees acted practically as a single body, while in the administration of policy they acted separately.

provide "rules for meeting problems arising through new factors, or changing conditions in the oil industry." [83]

Secrecy regarding the Heads of Agreement.—The consolidated minutes of the London "as is" committee covering the October and November meetings state—

> It was felt that in view of the inclusion of the new members and the consequent freer circulation which the new memorandum would have compared with that of the memorandum for European markets, it would be inadvisable, as far as certain countries were concerned, to refer too openly to the fixing of prices and the voting rights of members in this connection.[84]

Accordingly, it was decided that in contrast to the detailed procedures set forth in the memorandum for European markets, the clauses in the Heads of Agreements dealing with these matters should "be phrased on very general and noncommital lines." Hence, the Heads of Agreement contained only such indefinite clauses as the provision that the senior representatives would "cooperate to the fullest extent to get the best results and make the best possible use of the information obtained, not only in the matter of their position in relation to one another, but also of their position in the market as a whole." Of a similar character was the provision regarding large contracts that "the parties should discuss inter se selling conditions with a view to enabling the party holding contract to retain it if possible." [85]

The minutes of the meeting of the London "as is" committee on December 16, 1932, at which the Heads of Agreement were approved, state that—

> All parties were agreed that these minutes and the minutes of previous committee meetings should only be circulated to the head offices of the interested parties and *should not be sent by any party to local marketing representatives.* [Italics added.]

Thus, although the Heads of Agreement was to be a guide to field representatives in drawing up rules for local cartels or agreements, not even the "senior representatives of each part for the market in question or the next senior person as delegated by him to act in his absence" was to have access to the minutes.

Operations under the Heads of Agreement

The life span of the Heads of Agreement, 1933–34, fell within the worst period of the world depression. During these years, competition was held in check in most foreign oil producing countries. In the Middle East, the predominant position of the Anglo-Persian Oil Co.,

[83] It is not entirely clear from documents available whether the central "as is" committee and the London "as is" committee were to be one and the same. The Heads of Agreement provided that "a central 'as is' committee shall be formed, the members of which shall be representatives of each of the groups subscribing to 'as is.' All matters of disputes concerning the local interpretation of these arrangements, which cannot be settled on the field, or disputes concerning the principles on which 'as is' is based, shall be referred to this committee for settlement. The committee shall also provide, as the occasion arises, rules for meeting problems arising through new factors or the changing conditions in the oil industry." The December 15, 1932, minutes of the London "as is" committee "suggested" that the London "as is" committee, likewise, should make decisions "affecting major issues and matters of principle dealing with distribution 'as is'." but do not make it clear whether these matters would be separate and distinct from those for which a central "as is" committee was to be formed.

[84] Minutes of preliminary meetings of the London committee, October 24–25 and November 17–18, 1932.

[85] With respect to the matter of voting rights, however, the committee felt "that some method of deciding the voting rights in the fixing of prices in the various distribution markets should be developed and laid down in a separate memorandum of understanding," and that "this could then be included in the local agreements if thought advisable, taking into consideration the conditions in the country concerned." Minutes of the London committee, October 24–25 and November 17–18, 1932.

Ltd.,[86] was challenged in December 1932 by the annulment of its concession in Persia. This action was taken by the Persian Government on the ground that the company had not exploited the Persian fields while it had developed fields in other areas.[87] In 1933, however, Persia granted Anglo-Persian a new concession. Russia, which had refused the offer of the international companies to buy its oil, continued to be a potential threat to "as is" supply and distribution. However, Russian exports were restricted, and no flood of Russian oil appeared in the world markets.[88] Venezuelan production was largely controlled by Royal Dutch-Shell and Standard Oil interests,[89] and hence was subject to "stabilization."

Rumanian and United States production

By far the most difficult problems under the Heads of Agreement were those of Rumanian and United States production. About 2 months after the Rumanians signed the Paris agreement, the president of the Rumanian Association of Petroleum Industrialists was in Paris and London expressing the dissatisfaction of his group with the world price situation created by "the disastrous cut in American oil prices." On returning to Rumania, he took the position that if conditions in the United States were permitted to continue unchanged the whole of the Paris Conference decisions would be greatly endangered.[90] This complaint was referred to the Mixed Commission set up by the Paris Agreement. This body, consisting of the leaders of the large American and British companies, met in London with a delegation from Rumania during the last 2 weeks of February 1933. The Rumanians contended that the price situation in the United States "had gone from bad to worse," and threatened to abrogate the agreement at the end of the 3 months' trial period if the American situation was not improved.[91]

[86] Up to 1935, practically all of Middle East production was taken from Anglo-Persian's concessions in Persia. Production in Iraq, in which Anglo-Persian held a share, was less than 1 million barrels annually up to 1934, 7.7 million barrels in 1934, and 27.4 million barrels in 1935. World Oil, February 15, 1951, p. 246.

[87] According to the Petroleum Times, January 28, 1933, p. 94, the position of the Persian Government was that: "It is inadmissible that the extraction of oil should be confined for more than 30 years (out of the 60 for which the concession was made) to an area of a little more than 1 square mile. Yet such is the fact. The Anglo-Persian Oil Co. * * * is constantly extending its activities outside Persia, but in Persia it confines itself to a restricted exploitation. * * *."

[88] The Petroleum Times, February 3, 1934, p. 100, noted that Russian crude oil production had showed no increase during 1933 and that its exports were 22 percent less for the first 11 months of 1933 than they were in 1932.

[89] The Petroleum Times, February 3, 1934, p. 111, divides Venezuelan production for 1932 and 1933, as follows:

Company group	1932		1933	
	Barrels	Percent	Barrels	Percent
Royal Dutch-Shell	51,224,383	44.1	53,072,264	44.6
Standard Oil Co. of New Jersey	47,376,600	41.1	51,222,288	43.0
Others	14,708,786	14.8	14,709,162	12.4

Gulf Oil Corp. accounted for most of the crude oil produced by "others."

[90] A Petroleum Times editorial, discussing the world outlook for 1933, stated that there was too much price cutting in the United States, which would have to "play the game" and see that its export prices conformed with those outside the United States. The Petroleum Times, January 7, 1933, pp. 15–16. A month later another editorial declared that "The international group must raise prices in the United States." The Petroleum Times, February 4, 1933, p. 118.

[91] Ibid., February 25, 1933, p. 208.

At the end of the conference it was officially announced that the meeting had "dealt with the details of the machinery of the efficient operation of the agreement." It was stated that, as its contribution, in an attempt to bring "fuller cooperation between the [United States] legislative authorities and oil companies in the matter of proration measures," Standard Oil Co. of New Jersey would not draw oil from storage and would "refuse all orders which would bring production above the set limit." Arrangements were made for further meetings in Paris.[92] It was reported that an advance in United States domestic prices along the whole Atlantic coast might take place.[93]

Following this meeting, an International Petroleum Bureau (apparently the central "as is" secretariat) was set up in London as a "private body formed on behalf of the groups which have taken part, its objects being to collect statistics and information on the oil trade and such matters of value in connection with any agreements that may be made." [94]

During the last week of March 1933, oil conferences were held simultaneously in the United States and Paris. They were said to indicate that "the oil industry is determined by some means or other to lift itself from its present ignominious position.[95] A conference took place during the first week of April between Secretary Ickes of the United States Department of the Interior and the governors of oil-producing States who were considering ways and means of conserving the oil resources of the United States.[96] Individual State action was then under consideration, but neither effective State laws nor approval by the Congress of joint action by the States through interstate compacts then existed. Therefore, neither the governors nor the Federal officials could do more than recommend restriction of production by individual producers.

The Paris conference closed a week later. The British and American interests apparently were unable to give satisfactory assurances that American production would be restricted and Gulf prices advanced. The Rumanians, therefore, insisted upon greater freedom to produce and sell. It was reported that the Paris conference closed with a number of understandings, of which the following were the most important: (1) The Rumanians retained the right to continue to produce 18,500 tons of crude oil daily; (2) the Rumanians obtained the right to sell in any countries where they could find purchasers, but the international group requested the Rumanians to export outside Europe only if they first offered their products to the international group and only if the price offered by the international group was less than that offered by other buyers; (3) the international group agreed to buy 20,000 tons of kerosene and a like quantity of motor spirit (gasoline); and (4) if United States prices showed no advance and United States production was not kept within

[92] Ibid., March 4, 1933, p. 222.

[93] This advance failed to develop, due to continued unrestricted production and competitive selling of crude oil, especially from the newly discovered East Texas field. According to the Oil Paint and Drug Reporter, the field price in East Texas fell from 98 cents per barrel in October and November 1932 to 10 cents per barrel in May 1933. The posted price for export from Gulf ports fell from 90 cents per barrel in November 1932 to 32 cents by the end of January 1932, and to 30 cents in May and June 1932.

[94] The Petroleum Times, March 25, 1933, p. 304.

[95] Ibid., April 1, 1933, p. 332.

[96] Ibid., p. 335.

the limit of 2 million barrels daily, Rumanian producers would be free to terminate their agreement altogether without notice.[97]

In May 1933, American production had not been reduced. Independent producers, especially in the newly discovered east Texas field, flooded the market with oil. The big companies thereupon posted prices as low as 10 cents per barrel in the east Texas field and 30 cents per barrel for export from Gulf ports, allegedly in an attempt to drive the independents out of the market.[98] The disgusted Rumanian Association of Petroleum Industrialists thereupon unanimously agreed not to follow the restrictions on output imposed by the Paris agreement.[99] But this decision did not mean that the Paris agreement was wholly abrogated. It was reported that the Rumanians were willing to revert to the limitation imposed by the Paris agreement when American production was brought under control and output limited to about 2 million barrels per day,[1] but that further Paris conferences would be postponed until "America gets into line".[2] The suspension of the Rumanian agreement continued well into 1934,[3] with the Rumanian producers exporting 20 percent more oil in 1933 than in 1932 and shipping a few cargoes as far as Canada and Australia.[4]

Operational problems in other areas

Operations under the Heads of Agreement were also impeded by disturbances in a number of local distributing cartels. According to foreign trade press reports, in Germany, for instance, the cartel-minded German oil industry sought to gain greater influence and control in the domestic oil trade. The result was that although Standard (New Jersey), Shell, and Anglo-Persian had for years dominated both wholesale and retail distribution and had fixed prices and established quotas dividing the market among themselves since 1928, there were inroads upon their position due to increases in both domestic production and imports from outside sources. By 1930, oil from these outside sources, including Russia, provided a basis for operation of independent retail stations with the result that whereas independents had owned practically no retail pumps in Germany in 1928, they owned about 5,000 pumps out of an estimated total of 55,000 in 1933. With the introduction of this outside competition, the established price structure broke down.

In 1932, the dominant international companies sought to meet this growing problem by entering into an agreement to buy German domestic petroleum products and to market them in Germany before selling imported products. This arrangement was in strict conformity with the two principles of the Achnacarry agreement which dealt, respectively, with dividing the local market among the cartel parties

[97] Ibid., April 29, 1933, p. 435.

[98] The Petroleum Times, May 13, 1933, pp. 497–498, commented on: "Disturbing news from East Texas where the increase in production alone in the past few days is many times greater than the total output in Rumania, and this formidable increase in production has been met by the international group posting crude prices down to 10 cents per barrel in order to kill the efforts of the independents * * *." See also Oil Paint and Drug Reporter price quotations covering that period.

[99] Ibid., June 30, 1933, p. 570.

[1] Ibid., June 10, 1933, p. 597.

[2] Ibid., July 1, 1933, p. 2.

[3] Ibid., May 19, 1934, p. 529. Following informal international oil "chats" in London between several leaders of the American oil industry and representatives of Royal Dutch-Shell and Anglo-Persian Oil Co., it was reported that statements by W. S. Farish, president of Standard Oil Co. of New Jersey, indicated that no world stabilization agreement would be possible until the American situation was secure.

[4] Ibid., December 23, 1933, p. 741.

on the basis of past performance and of giving preference to local production in supplying local markets.[5] It had the effect, however, of limiting the supply available to independent wholesalers and retailers. The cartel's actions, therefore, came under criticism from these sources. It was charged that the quotas based on 1928 were unrealistic due to changed conditions. The arrangement under which the big companies purchased and controlled the marketing of German production also came in for criticism on the basis that "the German producer, thus relieved of worry regarding disposal of his production, has no say in the matter of price fixing."[6] The working of the quota system in Germany was also criticized as follows:

> The big companies want this rigid sharing of the market to survive these completely changed times. One of the basic ideas of the quota system is that the laggard shall be given a helping hand, either by diverting business to him or by granting him a pecuniary compensation; the market is also subjected to dangerous pressure by the frenzied efforts to maintain quotas which developments as a whole have rendered out of date. * * * The parties to the agreement have undertaken to absorb all additional German production before selling imported products, which means that the distributors place greater value on the maintenance of the status quo in the market, and thereby the utilization of their distributing organizations, than they do on finding an outlet for the wares of their own foreign parent companies.[7]

It was further charged that the three big importers—Royal Dutch-Shell, Standard Oil (New Jersey), and Anglo-Persian—had formed a defensive front against German producers and had reduced prices. The three big importers defended themselves against this charge in a memorandum presented to the German Ministry of Economy by the Erdol Reichsverband. This memorandum stated that although the three companies commanded a majority in the cartel:

> * * * all changes in prices during conventions since 1928 have been undertaken in the closest collaboration with the German producers, and have never been directed against the latter. When prices have been leveled up this has been done within the strict limits imposed by considerations concerning outsiders and the otherwise overburdened consumption; reduction in prices represented not the desire of the importers but defensive measures against dumping from other sources and against the incursions of the outsiders.[8]

Whereas in Germany the competition of independents was eliminated by purchasing their products, in England an important independent was eliminated by acquisition when Anglo-American Oil Co. bought out the Sealand Petroleum Co. The latter company had been 90-percent owned by Continental Oil Co. and had marketed Continental products competitively in the United Kingdom under the trade name "Dominion." In commenting on this acquisition, The Petroleum Times stated:

> Thus the Dominion petrol will cease to be one of the independents and will be price-controlled by the national distributing companies.[9]

Preparation for a new international agreement

In December 1932, the beginning of the 18-month period during which the Heads of Agreement were the accepted guide in the formation of local cartels, the outlook for effective control over the world petroleum industry was not too bright. The principal problem was, of course, the lack of restrictions on United States output and the

[5] Achnacarry agreement principles 1 and 4.
[6] The Petroleum Times, December 9, 1933, p. 710, quoting from Die Wirtschaft in Neuen Deutschland.
[7] Ibid.
[8] The Petroleum Times, December 16, 1933, p. 732.
[9] Ibid., p. 718.

refusal of the Rumanian producers to cooperate until American prices were stabilized. In fact, it was generally accepted in the trade that little could be accomplished until American Gulf prices had been brought under effective control.

But with the NRA code of fair competition for the petroleum industry,[10] a solution appeared to be in sight. Under the code the east Texas field price for grade A crude oil, which had dropped as low as 10 cents per barrel, was moved up from 50 cents in July to $1 per barrel in October 1933, with Gulf export prices advancing correspondingly. These prices remained unchanged throughout 1934.[11]

Efforts to take advantage of this change in the situation were not long forthcoming. In February 1934, it was reported that Rumania was as willing as ever to control her industry.[12] Shortly thereafter, it was stated that Rumanian and Iraq Petroleum Co. representatives would meet in March 1934, "to confer on the situation and attempt to reach some definite plan as to marketing." [13] In April 1934, a London meeting was attended by leaders of the American industry and representatives of Royal Dutch-Shell and Anglo-Persian interests. This meeting was described as "prompted no doubt by the necessity of some concerted action in the future when new sources of supply in the Near East will become available." [14]

Tanker rate cuts had also contributed to price differences in international oil markets. This problem was met by the formation of an international tanker pool under what was known as the Schierwater plan. The pool was stated to include all of the major ship owners in Denmark, France, Germany, Holland, Norway, Sweden, and the United Kingdom, and to have the support of all major oil companies engaged in the European trade. The plan provided compensation to owners for laid-up tankers. It was stated that American tanker owners were not members of the pool, but were trying to evolve a plan of their own.[15]

Thus, although operation under the Heads of Agreement fell short of its "as is" objectives in limiting Rumanian, Russian, and German production and distribution, and although difficulties were met in applying "as is" distribution in Europe and elsewhere, the international oil interests, after the adoption of the NRA code, were preparing for another attempt to implement their "as is" plan.

DRAFT MEMORANDUM OF PRINCIPLES, 1934

Nature of the draft memorandum

A renewed effort to stabilize the industry was made in April and May of 1934, when representatives of the major groups met in London to amend and reformulate the "as is" principles. By this time the major international oil companies had already acquired control of

[10] The National Industrial Recovery Act was approved June 16, 1933, and the code of fair competition for the petroleum industry was approved thereunder on August 19, 1933. See Codes of Fair Competition, vol. 1, p. 143.

[11] Prices quoted by the Oil Paint and Drug Reporter for the east Texas field advanced from 10 cents per barrel in May 1933 to 25 cents in June, 50 cents in July, 75 cents in August, 90 cents in September, and $1 on October 9, 1933. Thereafter, prices in this field remained unchanged throughout 1934. Gulf export prices trailed after these field prices, reaching levels ranging from 82 cents to $1.12 per barrel on October 9, 1933, and thereafter likewise remained stable throughout 1934.

[12] The Petroleum Times, February 3, 1934, p. 110.

[13] Ibid., February 17, 1934, p. 193.

[14] Ibid., April 14, 1934, p. 385.

[15] Ibid., March 10, 1934, p. 250.

most of the world's important producing areas. Venezuelan oil was largely under the control of Standard Oil (New Jersey), Royal Dutch-Shell, and Gulf interests; the pattern of Middle East control by Anglo-Persian, Royal Dutch-Shell, Standard of New Jersey, and several other large American interests was emerging; Rumanian production was dominated by the British, Dutch, and Standard Oil (New Jersey) interests, and Indian and Indonesian oil fields were controlled largely by the interrelated British and Royal Dutch-Shell interests.[16] This steadily increasing control of production by international interests, bound together by an intricate maze of joint ownership and contractual and cartel relationships, gave promise of less difficulty in the future in following a common policy.

At their London meeting the representatives of the major groups decided to give even greater emphasis to the twofold character of distribution controls which they had gradually developed, and which may be described briefly as (*a*) the establishment of over-all principles or goals (the "as is" principles), and (*b*) the application of those principles through the medium of local marketing agreements, which might vary in certain details from country to country, according to differing circumstances. Past experience had taught the groups that the "as is" principles could be considered as controlling only with respect to relations among themselves. They had come to recognize that in dealing with others these principles had to be regarded as only a desired goal. Difficulties in attaining the goal when dealing with outsiders through local marketing agreements were to be expected.

The draft memorandum was undated. However, a memorandum, entitled "Explanatory Notes With Regard to Draft Memorandum of Principles," was issued on June 27, 1934, by the London office. These explanatory notes describe the origin and purpose of the draft memorandum as follows:

> During these same meetings [London, May-June 1934] the memorandum for European markets dated the 20th or 21st January 1930 was revised and brought up to date, and attached you will find a copy of the new memorandum which is to replace the memorandum for European markets for all purposes.
>
> Although the memorandum is not dated, it has been agreed that it applies from the 1st of January 1934, and that therefore from that date this new memorandum should replace all existing local agreements which may have been developed on the lines of the memorandum for European markets. * * *

Thus the draft memorandum of principles was an amendment to the memorandum for European markets, carrying forward the same over-all principles and means for their attainment. In view of the proposed inclusion of outsiders, the draft memorandum was to be regarded as highly confidential. To guard against possible leakage, those charged with the duty of putting it into effect were advised that "this memorandum is to be treated with utmost confidence, and should not be copied or circulated, except possibly to responsible heads of

[16] In addition, the large international companies were planning to acquire control of new potential sources of production. In August 1934, Sir John Cadman of Anglo-Persian Oil Co., Ltd., made a trip to Australia "to investigate the possibilities of the Anglo-Persian assisting in the development of Australia's oil shales," and in November 1934, it was announced that a new company, owned jointly by Royal Dutch-Shell (40 percent), Standard Oil Co. of California (20 percent), and Standard Oil Co. (New Jersey) (40 percent), would thoroughly explore New Guinea for oil. See The Petroleum Times, August 18, 1934, p. 169, and November 3, 1934, p. 482.

departments affected by the arrangments."[17] Only the top officers of the major groups, who were charged with administration of the plan were to have full knowledge of its terms. In dealing with outsiders, the local agreements were to be treated as wholly separate. Participating outsiders were to have direct knowledge of the main agreement only to the extent that the London executives of the major parties might direct.

Terms of the draft memorandum

As in the case of the two predecessor agreements, the Draft Memorandum of Principles declared the main principle of maintaining "as is" to be "of an enduring nature." It quoted some parts of the 1930 Memorandum for European Markets word for word and revised, amended, and added to other parts. The result was that the 13 main clauses and 2 addenda of the Memorandum for European Markets were expanded into 24 numbered clauses and 6 addenda. Inasmuch as the draft memorandum closely followed the broad "as is" principles and procedures of the 1930 memorandum, the ensuing discussion will give attention primarily to new clauses and interpretative provisions.

The preamble stated that the draft memorandum was "to cover all countries to the extent that it is not contrary to law." This provision extended the application of the "as is" principle to distribution markets throughout the world, whereas only European markets were covered in the earlier Memorandum for European Markets. Excepted, because of the antitrust laws, was the United States, as well as any other country in which the provisions would be contrary to law.

A new feature was a provision that in any market where all participants were already, or might in the future become, members of a local cartel, the major parties might agree, by unanimous consent, that the local cartel would "override this memorandum for that market and product for the duration of such cartel." This provision gave the members greater freedom to make the best possible bargain with outsiders. However, it was subject to a requirement that any new local agreements made with outsiders "should be developed on the same lines as * * * the memorandum as nearly as possible."[18]

As under previous agreements, it was stipulated that the term of local agreements would be "of indefinite duration, unless terminated by 1 month's notice, which may be given at any time." It was further provided, however, that since the "as is" principle was of a durable

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[17] Full text of the explanatory notes dealing with the confidential nature of the draft memorandum and its application in local markets is as follows:

"Before proceeding to discuss certain special clauses of the memorandum, it is important that you realize that this memorandum is to be treated with the utmost confidence, and should not be copied or circulated, except possibly to responsible heads of departments affected by the arrangements. Should it be necessary for certain departments to have frequent access, for working purposes, to this memorandum, it is suggested that only excerpts as required by the department concerned should be made for their purposes.

"The new memorandum applies only to the major parties in your area and is neither to be discussed nor disclosed to any other party who is in, or in the future may be brought into, any of the local arrangements in your market without prior reference to London. Although it is foreseen that other parties may enter into "as is" arrangements in the local markets with the major parties, and although the working arrangements with them should of course be developed if possible on the lines of this memorandum, it is advisable that such local working arrangements should be developed apart from the memorandum and by separate agreement. In other words, if in your market it should be decided to enter into an arrangement with other parties, the major parties operating there should make jointly a separate agreement with the new party, and that agreement should be developed on the same lines as the attached memorandum, as nearly as possible."

[18] See footnote 17, above.

nature "such termination shall not prevent the participants from endeavoring to get together to find a basis for its renewal."[19]

The products to be covered in local agreements were specified in more detail than in the predecessor memoranda. They were as follows:[20]

Gasoline (including turpentine substitutes and other white spirits)
Kerosene and tractor kerosene
Fuel oils (excluding bunkers)
Gas and Diesel oils (excluding bunkers)
Bituminous products

Determination of quotas and adjustments for undertrading and overtrading

As under previous agreements, the parties were to meet locally and determine as accurately as possible the total consumption of each market, including quantities supplied by outsiders, for the necessary base and other operating periods. All basic data for quota purposes were to be supported by an independent auditor's certificate. On the basis of the assembled data, the local participants were to determine "*the percentage of the total done by each participant in each product during such periods.*"[22] The explanatory notes accompanying the memorandum state that "It has been agreed upon that the basic year for the parties remains in principle the year 1928 for all products"—the year originally adopted under the Achnacarry agreement.[23]

The question of how to deal with sales and exchanges of products among participants was disposed of by the statement that:

> Sales by one participant to another arranged for their mutual advantage are at all times permissible. Such sales shall not be taken into account in calculating the performance of the supplying participant with regard to distribution quotas.[24]

It was also agreed that sales of crude oil were to be made to certain independent refiners—

> * * * in various countries that have a position in the market and while it is not the intention to improve that position neither is it the intention to deny to

[19] The effects of experience under the Rumanian agreement previously described appear to be reflected here.

[20] For the application of these classifications, it was provided that: "It is to be determined locally whether the grouping of such products for quota purposes as hitherto applied requires alteration." As under previous agreements, benzol, alcohol, and other products not derived from petroleum were to be included to the extent that they were marketed either in competition with or mixed with petroleum products. It was also provided that each local cartel would define the type of ship to which sales of petroleum products would be considered at bunkers and, therefore, excluded from local market sales for quota purposes. Bituminous products were defined by addendum 4 as "Bitumen, Asphalt, Fluxes, cut-backs, road oils, fuel oil, or other Petroleum Products used as road materials * * * or mixed with bitumen for industrial purposes." All petroleum products so used were to be counted at their full tonnage. Lubricating oils were specifically excluded but were to become subject to the provision that "any working agreements (if later developed) for these products will be covered in a separate memorandum."

Further provisions indicating refinements in computing quantities for quota-making purposes were that where nonpetroleum products were mixed with bitumen, only the bitumen content was to be included, and that the bitumen content of emulsion delivered into consumption by emulsion companies, whether or not these companies were controlled by a participant, was not to be counted. However, any bitumen sold to such companies was to be counted as sold to a buyer. Also, it was agreed that the net weight of bitumen counted would be computed by deducting from the gross weight a percentage to be agreed upon locally as representing the weight of packages.

[22] Italics added.

[23] The provision that, in principle, products consumed by the participants as well as quantities consumed by outsiders were to be excluded in determining consumption figures, and the provision for local monthly meetings for exchange of participants' data and estimates of outsiders' trade, were carried forward from earlier memoranda of agreement. Also it was definitely stipulated that the monthly local meetings should be attended by only the senior representative of each participant for the market in question, or such senior person as delegated by him to act in his absence.

[24] Draft memorandum of principles, clause XX.

the participants the right to sell crude to such refiners and thereby forcing a crude supply outlet to outside suppliers.[25]

Such sales both to participants and to outsiders were to be included in the supply quotas of the various participants, but were to be excluded from their distribution quotas for the reason that quantities of the products so supplied would be included in the distribution quotas of those receiving them. This, in effect, required the setting up of two types of quotas, one, a supply quota, covering the total quantity of each product to be supplied by each participant, which would include sales to other cartel members and outsiders, and the other, a distribution quota which would cover the quantities to be distributed by each participant directly to consumers, wholesalers, and retailers in the market.

In general, the provisions governing the determination of overtrading and undertrading in earlier agreements were simply carried forward. It was emphasized that with real cooperation "over and undertrading among the participants should not arise." If, however, overtrades and undertrades occurred, they were to be adjusted by transfer of customers or by compensation to undertraders and fines against overtraders. The rules for cash compensation to undertraders and for restoration of the undertrader's quota were spelled out in greater detail, by definitely providing that the overtrader should buy from the undertrader the quantity required to restore the undertrader's "as is" quota percentage. This was to be done in all cases except where the undertrader withdrew entirely or partially from the market.[26] If the undertrader refused to supply the overtraders during any period of 3 months, it was provided that:

> * * * The undertrader shall be deemed to have voluntarily retired from the market by a percentage equal to the drop in his percentage position over the 3 months caused by his undertrading or by his final undertrading position at the end of the year, whichever percentage of undertrading is the smaller. In that event his quota for the ensuing year shall be reduced by 75 percent of that percentage so undertraded and fines for such overtrading shall be waived.

The percentage lost by withdrawal of an undertrader was to be added to the quotas of overtraders in proportion to their respective quotas. The overtraders, of course, were to dispose of their increased tonnage at the prevailing market price.

As under earlier agreements, it was provided that the parties would meet and agree upon a price to cover allowable expenses, which the overtrader would retain in making compensation to undertraders. The intention was declared to be that the price paid as compensation would be such as to place the overtrader:

> * * * As closely as possible in the position in which he would have been had he not traded in excess of his quota and *that he should not get the benefit of the contribution to his overhead arising out of his increased volume.*[27]

It was agreed that compensation for overtrading should be made in the market and in the local currency of the market when it fell due. It was recognized that under certain circumstances "it may be difficult to require the overtrader in a given market and a given product to purchase that product at a price which is out of line with the market price prevailing at the time the compensation is actually effected." As a matter of expeditious handling, however, it was proposed that the

[25] Ibid., addendum I, par. 2.
[26] Except in cases where withdrawal was due to force majeure.
[27] Italics added.

overtrader would compensate the undertrader by outright purchase "on the basis of the prevailing market price at the time such compensation is made," and that any difference between the market price actually paid and the price calculated under the general procedure outlined above as that which the overtrader should pay would be subsequently adjusted.[28]

A new basis for determining fines for overtrading was adopted, using sliding scale percentages based on the Gulf f. o. b. price.[29]

The method of apportioning fines to undertraders was also altered to provide a more equitable apportionment. Specifically, it was changed from a division in "*proportion to their respective quotas*" to apportionment "*in proportion to their respective volume of undertrade.*"[30] In short, the undertraders were to be reimbursed from the fines in proportion to their loss of trade rather than in proportion to their quota.

As before, large contracts were—

> in principle the right of the participant holding such contract during the basic period, unless subsequently lost to an outsider.

It was also agreed, as before—

> that such contracts are a useful type of business for the purpose of making current trade adjustments * * * to avoid over- and under-trading.

Large contracts, however, were not to be transferred without the consent of the previous seller.

Revision of quotas

Past experience had indicated that there were various circumstances which required the revision of "as is" quotas. The previous agreements had not embodied specific procedures for making such revisions. Rules were therefore established which would govern the revision of quotas for the following reasons:

(1) As a penalty against any participant who, in any accounting period, undertraded by more than 5 percent of his quota;

(2) Upon the admission of new members;

(3) Upon the acquisition of outsiders by purchase;

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[28] All prices paid and subsequent adjustments would be in terms of the local currency of the market, and one currency could not be substituted for another except by mutual consent of the parties.

[29] The earlier agreement had provided for fines assessed on a sliding scale such that if a participant overtraded to the extent of about 9 percent of his quota, he would be paying as a fine the total marketing expense per unit which it was agreed he should retain in making cash compensation to undertraders. Under the new plan the fine for overtrading for the first 1 percent or fraction thereof in excess of a 5-percent tolerance permitted for overtrading was to be 5 percent of the Gulf price. For each 1 percent of overtrades up to 10 percent, an additional 5 percent of the Gulf price was to be assessed. For any quantity overtraded in excess of 10 percent the penalty was to be a flat 35 percent of the Gulf price.

[30] Italics added. The full text of the provisions of the draft memorandum respecting the computation of fines and their disposition was as follows:

"The fines which the overtrader shall pay for the quantity represented by his overtrade in excess of 5 percent of his allotted quotas shall be:

"(*a*) For each unit of the overtraded quantity represented by the initial 1 percent of his allotted quota or fraction of that 1 percent, in excess of his 5-percent overtrade, the fine shall be 5 percent of the Gulf f. o. b. price for the equivalent product according to Platt's Oilgram averaged for the accounting period under consideration.

"(*b*) For each unit of the overtraded quantity represented by the second, third, fourth, and fifth completed 1 percent or fraction thereof, in excess of 5-percent overtrade, the fine shall be 10 percent, 15 percent, 20 percent, and 25 percent, respectively, of the Gulf price for the product as calculated under (*a*) above.

"(*c*) For each unit of the quantity of overtrade in excess of 10 percent of the overtrader's quota the fine shall be 35 percent of the Gulf price for the product as calculated under (*a*) above.

"The amount paid in fines by the overtrader shall be apportioned among the undertraders in proportion to their respective volume of undertrade."

(4) When a participant voluntarily retired from the market in whole or in part;

(5) When the use of one product developed in such a manner that it eventually replaced another product, either wholly or in part.

In the case of (1) above, the undertrader's quota was to be reduced for the ensuing accounting period by distributing to the other participants "one-quarter of the amount by which his undertrading exceeds his 5-percent margin." Distribution of his loss of quota to other participants was limited to "overtraders' pro rata to their respective overtrading."[31] Thus only those who overtraded were to be the beneficiaries of any quota losses by undertraders. Activity rather than indolence was to be rewarded in such adjustments of quotas.[32]

Revision of quotas resulting from the admission of outsiders "on such conditions as might be mutually agreed upon by the parties" merely carried forward an elastic provision of the Heads of Agreement of 1932.[33] However, the explanatory notes which accompanied the draft memorandum make it clear that the Achnacarry agreement's basic year for "as is" quotas, 1928, was to be abandoned only when necessary to obtain the adherence of important outsiders.

The acquisition of outsiders was the third reason agreed upon as necessitating adjustment of quotas. Acquisitions had always been recognized as a desirable means of bringing competitors within the cartel's orbit. But problems arose in handling the quota revisions resulting therefrom.

The 1934 Draft Memorandum of Principles repeated the strict provision of 1930 for sharing in purchases of local outside distributing concerns.[34] In addition, rules for applying this provision under three special circumstances were spelled out as follows:

(*a*) If the acquiring participant had previously supplied the acquired local distributor for at least 2 years, it was agreed that the acquirer would have the right to retain for his own account a percentage of stock control of the acquired outlet equal to the percentage of the outlet's total supply which the acquirer had furnished during the preceding 2 years. The other participants were to be entitled to share the balance of the stock control pro rata to their respective quotas.[35]

(*b*) If the acquiring participant's quota in any product in the local market was less than 15 percent, it was agreed that, by mutual consent

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[31] Under the previous Heads of Agreement, the distribution was to be to all participants "who are not undertraders in excess of their 5-percent margin, *pro rata to their respective quotas.*" [Italics added.]

[32] In addition, the complicated earlier scheme of adjusting for undertrading at the end of each consecutive 2-year period was abandoned in favor of adjustment at the end of each accounting period.

[33] Strict application of the 1928 "as is" agreement respecting quotas broke down when it became necessary to give Rumanian outsiders larger quotas in order to obtain their signatures to the 1932 Rumanian agreement.

[34] Under the 1930 Memorandum for European Markets it was agreed that any of the three major parties desiring or having an opportunity to purchase a local distribution concern would offer a pro rata participation to the other parties. The 1932 Heads of Agreement laid down no procedure for handling this matter more specifically than to recommend that since the purchase of outsiders "is in principle the equivalent of admitting new members to 'as is' * * * such purchases shall be frankly discussed between the parties interested before the purchase is completed."

[35] The full provision of the agreement was: "Should any participant, for a period of at least 2 years, immediately preceding the time at which he acquires a local outside distributor, have supplied such local distributor, such participant has the right to retain for his own account the proportion of stock interest and supply represented by his share in the supplies of the total requirements of such local outside distributor during the abovementioned 2 years, the obligation to offer a participation of stock interest and supplies to the other participants being limited to the balance, in which all participants shall be entitled to participate pro rata to their quotas" (Draft Memorandum of Principles, clause XIX).

of the other participants, the acquirer might be permitted to retain such portion of the outsider's business as would bring the acquirer's quota up to 15 percent of the total market consumption. The remaining participants would then be entitled to share pro rata to their quotas only the balance of the acquired company's business in the product or products concerned.[36]

(*c*) It was further agreed that the conditions described in (*a*) and (*b*) would not prevent any participant who previously had no direct or indirect share in distribution in the market from acquiring a local outside distributor, provided notice was given to the other participants and provided that the purchase did not directly displace the supply outlet of any other participant in the main agreement.[37]

Voluntary retirement from the market was the fourth condition agreed upon as necessitating a revision of quotas. This matter was especially troublesome for several reasons. In the first place, it was necessary to permit withdrawals for various good business reasons, such as lack of supply, low profit on sales in the particular market as compared with sales in other markets, force majeure, etc.[38] In the second place, retirement for whatever reason, whether permanent or only temporary, and whether in whole or in part, caused the retiring party to become an undertrader.[39] Therefore any withdrawal by any party raised questions as to how long and to what extent the withdrawing party's quota in the market would be protected and what arrangements would be made for offsetting the reduction in supply.

An attempt was made in the Draft Memorandum of Principles to answer these questions by making a distinction between competitive under- and over-trading and deliberate withdrawal from the market. The former was to be handled as outlined on page 257. In the case of the latter, new rules were adopted providing that if a participant withdrew from a market either entirely or partially for reasons other than force majeure, an overtrader would have the right at the end of any 3-month period to call upon the undertrader to state whether he would "supply to the overtrader the amount thus undertraded during that 3-month period in return for the overtrader's pro-

[36] Full text of the provision was: "If any participant with a quota of less than 15 percent in any product in any market shall acquire an outsider, such participant by mutual consent of the other participants may be permitted to retain such portion of the outsider's business in the product or products concerned as shall bring his total quota in that product or products to 15 percent of the total market consumption, and he and the other participants shall then be entitled to share pro rata to their quotas only such portion of the business acquired as would bring his quota in the relative product or products above 15 percent of the total market consumption" (ibid.).

[37] The provisions in the agreement was that—

"The foregoing shall, however, not prevent the purchase of such a local outside distributing concern by any of the participants if he has in the market in question no direct or indirect share in the distributing trade in which the purchased concern is engaged: provided always that the other participants are informed and the purchaser does not displace directly the supply outlet of any participant who is a participant to the main arrangement in respect of the country in question." Ibid.

[38] Retirement for any of these reasons might be entire or only partial, and might be permanent or only temporary. It might take the form of failing to supply another participant under an exchange arrangement among the parties or of failure to supply outsiders formerly supplied in the market. Furthermore, it might be done in good faith for sound business reasons openly declared, or it might be done surreptitiously in an attempt to retain a quota position in the market pending improvement in prices therein or improvement in the retiring party's situation with respect to supply or cost of products.

[39] Even temporary withdrawal raised questions as to who among the remaining participants should or would supply the quantity of products necessary to maintain the "as is" position of the group and on what price basis these products should be supplied in the interim. Permanent withdrawal posed similar questions as to who would permanently take over the supply. If the other parties stepped in and supplied the retiring party's share and permitted him to retain his quota position, they became overtraders obligated to make cash compensation to the undertrader.

ceeds less expenses."[40] If the undertrader declared his unwillingness to supply the overtrader on this basis, it was provided—

> the undertrader shall be deemed to have voluntarily retired from the market by a percentage equal to the drop in his percentage figure over the 3 months, * * * or by his final undertrading position at the end of the year, whichever percentage is the smaller.

In that event, it was agreed that the undertrader's quota for the ensuing year would be "reduced by 75 percent of that percentage so undertraded and fines for such overtrading [by others] would be waived."[41]

These provisions were obviously designed to stimulate effort on the part of any participant to furnish the supply necessary to maintain his quota. Only if he was willing to sacrifice his own future position could he afford to withdraw, even temporarily or partially, from the market.

Finally, the new agreement gave special consideration to the adjustment of quotas resulting from the displacement of one petroleum product by another, as, for instance, Diesel fuel oil displacing gasoline previously sold. In such cases it was declared to be the intent that the party who previously had the outlet for the displaced product "*should be entitled to an equivalent outlet for the replaced product.*" In practice, this amounted to treating the two products as interchangeable for quota purposes. To make the necessary adjustments, customers for the new product might be traded or large contracts might be so divided by agreement among the parties as to maintain each participant's over-all "as is" quota for the two products combined.[42]

Prices and terms of sale

The general principle set forth in the draft memorandum respecting prices was that:

> Prices should be maintained in all markets on a basis which should yield a fair return on a reasonable investment, having due regard to encouraging the use of petroleum products. It is important that prices should not be permitted to rise to a point where the buying public is exploited.[43]

To implement this principle, the "majority rule" for voting on the fixing of prices was carried forward from the 1930 Memorandum for European Markets. There the "majority rule" had been described as specifically applicable to large contracts which the participants were to hold against outsiders on an agreed-price basis. In the 1934 draft

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[40] Draft Memorandum of Principles, clause XVIII.

[41] It was further agreed that the percent so lost by the undertrader would be added to the quotas of the other participants "who have not undertraded in proportion to such participants' relative percentage performances during the year in question provided that such participants are prepared to deliver their proportionate share of the supplies" at the compensation less expense price which the undertrader would have been entitled to receive had he supplied the overtrader. Ibid.

[42] An addendum to the draft memorandum dealt in detail with the method of adjustment to be followed, using the case in which gas oil had replaced gasoline for automotive purposes as a concrete example. In such case, it was provided that all "participants shall have the right to market Automotive Gasoil in accordance with their gasoline quotas." In markets where the fuel used by Diesel engines for automotive purposes could be accurately estimated it was declared that: "* * * the Automotive Gasoil shall be considered as a separate product and the rights of the participants to market Automotive Gasoil shall for all 'as is' purposes be in accordance with their rights under their gasoline quotas in the market in question."

In markets where such segregation of gas oil use was impossible, existing gas oil quotas were to be so revised, "that each participant's revised quota for gas oil shall protect not only their right to market Automotive Gasoil in accordance with their quota rights for gasoline, but also their right to market gas oil for purposes other than automotive in accordance with their previous gas oil quota." Ibid., addendum VI.

[43] Ibid., clause XVI.

memorandum the scope of price fixing was broadened to include "price movements up or down." Such movements were to be "governed by the majority, each participant having one vote for each complete 1 percent of quotas * * *."[44] Concerted price fixing was to be suspended only if the group's aggregate percentage performance, or that of an individual member, fell below 95 percent of its, or his, "current share" of the market.[45] If this occurred, it was agreed that the participants or individual participant whose share fell below 95 percent "shall have liberty of action regarding changes in selling price, except that the selling price may not be reduced below the price quoted by outsiders less 20 percent." This liberty, however, was to continue only until "the group's percentage is restored to the aggregate of the current quotas and no participant is below his individual quota." It was further agreed that thereupon: "a majority vote shall be sufficient to increase selling prices and to establish the actual increase." Thus, there was to be no individual freedom of price action except to restore "as is" quota positions.

A member could act independently, taking such action as regards prices as he may deem desirable, if he felt that his investments as a producer in any market would be detrimentally affected by the operation of a majority vote in connection with prices.[46] But this escape clause was more apparent than real, since in no case was a participant

> * * * entitled to effect a change in prices, discounts, or allowances *without giving the other participants notice* of their intention to change selling prices and an opportunity being afforded for *discussion* of the contemplated change, nor *without all participants being informed prior* to any change in price as to the amount and scope of such change and the points at which and the class of business to which such change shall apply.[47]

Thus, the pricing system combined open price reporting and open discussion of proposed prices with binding price agreements in local markets. These general pricing provisions were to apply to sales for consumption as distinguished from sales between participants. The latter, arranged for mutual convenience, were at all times permissible. The former included not only sales directly to consumers but also sales to other marketers, some of whom might be outsiders. In regard to outsiders the draft memorandum stated:

> It is agreed that, except as provided for in addendum I on sales to outsiders, none of the participants to this agreement shall, directly or indirectly, effect such sales.[48]

The exception in addendum I was to the effect that sales to outside refineries could be made with the consent of the members in the market involved:

> except for supplying a position actually established, as per a schedule to be determined, sales of crude or finished products shall only be made to outsiders

[44] Thus the weight of each participant's vote was determined by the size of his quota. For the origin of this method of voting, see p. 232 above.

[45] "Current share" was defined as follows: "Current share for the whole group (or the individual participant, as the case may be) is to be defined as the distribution quota of the whole group (or that of the individual participant as the case may be) unless, during the trimester immediately preceding the month in question, the percentage performance in distribution of the whole group (or the individual participant as the case may be), is greater than its (or his) quota, in which case 'current share' is to be defined as the percentage performance of the whole group (or the individual participant) during the said trimester." Draft Memorandum of Principles, clause XVI.

[46] This exception, amounting to an escape clause available to any participant at any time, was couched in such general terms that it could cover a case in which a participant was reluctant to follow either a price increase or a price reduction determined by majority action of the group.

[47] Draft Memorandum of Principles, clause XVI. [Italics added.]

[48] Draft Memorandum of Principles, clause XX.

by consent of the participants who are operating in the market to which such crude or finished products are destined, or, if the destination is unknown, by the consent of all participants.[49]

The reason for permitting sales to outside refineries at all was to prevent them from being supplied by outside crude producers:

> It is recognized that there are certain refineries in various countries that have a position in the market and while it was not the intention to improve that position neither is it the intention to deny to the participants the right to sell crude to such refiners and thereby *forcing the crude supply outlet to outside suppliers.*[50]

Under the procedure laid down, the participants were to establish annually a list of outside refineries to which they would sell crude oil to prevent "forcing the crude supply outlet to outside suppliers." They were also to determine but not "improve," the position of the outside refiners. The next step was to allocate this quantity to the various members. This was to be done in proportion to each participant's "over-all percentage in the total consumption of all products in the market in question." [51] A similar procedure was laid down to cover the sale of refined products to outside marketers.[52] Finally, it was agreed that "except as hereinbefore provided for, *no participant shall be free to sell to outsiders either crude oil or finished products.*" [53]

Sales to outsiders were likely to fall in the category of large contracts. In regard to such sales, the members were to discuss and agree upon prices and selling conditions among themselves. Wherever possible, the previous supplier was to retain the contract. This provision applied to contracts with Government agencies, municipalities, public institutions, cooperatives, and all other large consumers. If through cooperatives or similar groups customers combined their purchases in such a way that a participant was prevented from supplying a previous customer, it was provided that—

> the participant or participants having obtained the business so lost [shall] compensate the losing participant or participants by ceding an equivalent customer.[54]

The purpose of these provisions regarding large contracts and sales to outsiders is clear—to set up a way of excluding outsiders and allocating to the members the total supply in accordance with their "as is" position. The "as is" position of independent refiners and marketers was to be recognized only to the extent necessary to prevent them from becoming market outlets for outside suppliers. If outside suppliers could be excluded, the control of the cartel over outside refiners and marketers would be complete, and no independent refiner or marketer could exist except by unanimous consent of the cartel members.

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[49] "Consent" was defined as follows: " 'Consent' means that the participants shall agree to an estimate in advance of each year of the outside buyers to whom the participants can rightfully sell and the volume of crude in each market involved (always excepting the volume included in the established position of the participants as covered in the schedule referred to above)." Draft Memorandum of Principles, addendum I.

[50] Ibid., addendum I. [Italics added.]

[51] If any participant elected not to "quote on his allotted quota, or any part thereof, then the quantities so surrendered shall be divided pro rata between the other participants, based on their position in the market in question." Ibid.

[52] Such sales, other than those included by the schedule covering positions actually established, required consent of the parties, and the right to supply any excess quantity so consented to was to be offered "pro rata to the distribution of quotas of the participants for the product and the market in question." Such offers were to be accepted or rejected promptly by each participant, and the remaining participants were to "be entitled to share the quantities so rejected pro rata to their quotas." Ibid.

[53] Italics added.

[54] Draft Memorandum of Principles, clause XV.

Competitive marketing expenditures

The draft memorandum placed great emphasis on the necessity of eliminating unnecessary sales costs, particularly advertising expenses:

> With a view to reducing unnecessary expenditure and thus enable the participants hereto to supply the public at lower costs, it is agreed that budgets covering certain items of capital expense and advertising budgets, should be, insofar as possible, agreed upon for each market by the participants in that market before being submitted for consideration to London *with a view to eliminating unnecessary duplication or expense* which only serves to increase the cost of distribution and thus places an unnecessary burden on the consumer.[55]

Addendum V, entitled "Economy in Competitive Expenditure," provided a specific procedure to be followed in formulating budgets. With respect to new equipment for distribution, each participant in each market was charged with the duty of compiling an annual budget which was to be screened by the other members for unnecessary expenditures and then forwarded to London for review:

> Before submitting the budgets to London the participants must discuss these items between themselves, and ascertain to what extent, by cooperating in installing such equipment items can be eliminated from this preliminary budget, so as to avoid expenditure by one participant being offset and canceled out by similar expenditure by one or more of the other participants. It may be found either that the participants can agree and reduce the budget which they will submit to London for review, or that a difference of opinion may exist as to the necessity for expenditure under certain headings by one or more participants.[56]

A similar procedure was to be followed with respect to advertising expenses, with a view to—

> mutually eliminating such items of advertising expenditure as can be dispensed with without detriment to the normal sale of each participant's products * * *[57]

The following advertising items were specifically cited as subject to reduction:

1. Road signs and billboards—to be reduced or eliminated.
2. Newspaper advertising—to be kept within reasonable limits.
3. Premiums to racing drivers—to be reduced or eliminated.
4. Novelties, such as cigarette lighters, pens and pencils, calendars, paper weights, etc.—to be reduced or eliminated.
5. Number and type of signs placed at dealers' garages—to be standardized to reduce unnecessary expenditure.

Other advertising items were also to be discussed and the whole advertising program, as agreed upon locally, was then to be forwarded to London for review.[58]

A year later an "addition to addendum V" was adopted and declared to constitute a part of the Draft Memorandum of Principles. This "addition," dated October 28, 1935, stated that occasions had arisen in which it was found necessary for a participant to amend a budget

[55] Draft Memorandum of Principles, clause XXI. [Italics added.]
[56] Ibid., addendum V.
[57] This procedure was to be followed in all countries, and with respect to all products, subject to the declaration that:
"While it is realized that conditions vary greatly in different countries and that upon the introduction of new products or new brands it may be impossible to make a comparison of advertising budgets for such new products or brands, nevertheless all other items of advertising and publicity can by agreement be materially reduced. * * *." Draft Memorandum of Principles, addendum V.
[58] An explanatory note accompanying the draft memorandum contained the following specific instruction:
"The procedure for implementing the exchange of details of intended competitive expenditure of the nature specified should at the first opportunity be agreed locally with other represenatives in order that before the end of October 1934 the agreed budgets for the year 1935 (beyond which no expenditure of this kind is to take place without previous local discussion) may be forwarded to London on the agreed lines." Explanatory notes with regard to Draft Memorandum of Principles.

figure previously agreed upon. It was, therefore, understood between the participants that—

> * * * the provisions of addendum V would apply to the amendments just as to the original budget and that consequently *no material change should be made to an agreed budget without full discussion of the other participants.*[59]

The draft memorandum stated that the purpose of these provisions "was to enable the participants hereto to supply the public at lower costs." Addendum V stated that it is "as much the interest of the consumer as of the participants that distribution of petroleum products is maintained whilst combining the greatest efficiency with the greatest economy."

Since under the cartel all members quoted the same price to any given buyer, competition in terms of price had been virtually eliminated. Hence, whatever rivalry existed among the members could be manifested only in terms of nonprice competition, and in the petroleum industry principal media of nonprice competition were distribution facilities and advertising. Thus, a cartel agreement which began as an attempt to limit production and fix prices was widened to include detailed restrictions on the number and kind of distribution outlets and on the volume of advertising expenditures.

Operations under the draft memorandum

The Draft Memorandum of Principles, adopted in June 1934, continued in subsequent years to be the charter of the three major companies in making local market agreements. In accordance with the declared policy and procedure, previously negotiated local agreements were not disturbed until their termination; but then an effort was made to renew them as nearly as possible along lines of the memorandum.

The activities of the major participants to implement the main agreement were carried out under the supervision of a London committee consisting of one representative of each participant. The memorandum provided for the setting up of this committee with broad powers "for the purpose of carrying out the provisions of this memorandum." It was agreed that to it "shall be referred all matters of disputes covering the interpretation of this memorandum, or any other questions which may arise as regards the operation of this memorandum." A duty specifically assigned to the committee was the arbitration of all disputes arising among participants in local markets.[60] In general, it was agreed that:

> It shall be the duty of the committee to cement and coordinate the relations between the participants with a view to obtaining the maximum cooperation, and the committee is authorized to set up such machinery as it deems advisable for the interchange of such information and statistics as may be required, and in general do all things necessary toward the proper functioning of this arrangement.[61]

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[59] (Italics added.) The addition also stated that it had been found in practice that discussion of budgets in advance was insufficient alone to achieve the intended purpose. It was therefore agreed "that at intervals during the period covered by the budget, the participants should exchange full information as to the progress of the spending of the amounts which have been agreed and further that as soon as possible after the close of the period an exchange should be made showing the figures which have actually been spent against the agreed-upon amounts."

[60] If the members of the committee representing the interested participants were able to agree on an equitable solution of the dispute, or if all members were in agreement on a question of interpretation, it was agreed that their decision was to be binding on all participants.

[61] Draft Memorandum of Principles, clause XXII.

In transmitting a copy of the draft memorandum, Standard of New Jersey stated that:

In or before the early part of 1938, verbal notice was given, in accordance with clause I of the Draft Memorandum of Principles, of termination of that agreement. Any activities that may have survived came to an end in September 1939, as a result of the outbreak of the war. They were never resumed.[62]

Theoretically, this notice should have ended cooperation of Standard of New Jersey interests under the draft memorandum. However, a special investigating committee of the Swedish Riksdag in 1947 found evidence of continued cooperation among the three major international companies in later years. This committee cited documentary evidence that in December 1938, Standard, BP (Anglo-Iranian), Shell, and Texaco agreed that a new agreement should be made to cover the Swedish market, and that such a new draft agreement was drawn up in February 1939, but was not formally signed. In evaluating the relationship of this new local agreement to the Draft Memorandum of Principles, the Swedish committee stated:

It appears from correspondence placed at our disposal that one of the concern companies notified its daughter enterprise in April 1939, that the Draft Memorandum of Principles which has been applied for the three major companies in Sweden as well as in other countries had, for reasons which they did not consider necessary to state, formally been canceled. However, the intention had not been that the basis of the cooperation should in reality be changed. The only actual alteration was that, while the draft memorandum had been a document which had been generally applicable in all countries, matters must now be so arranged that the companies had to reach their own agreement on about the same lines as the draft memorandum, but with the modifications which had proved to be necessary for the adaptation of the local conditions.[63]

The Swedish investigating committee further found evidence that it was not until 1942 that the Swedish subsidiaries of the American companies had—

been informed by the parent companies that agreements of the kind now in question [Swedish local agreements] must no longer be made because such agreements might be at variance with American antitrust legislation * * *.[64]

It appears that even then cooperation did not entirely cease for the same investigating body found that as late as 1943 some company representatives in Sweden had discussed an adjustment of over- and under-trading and that, at the end of 1946, negotiations were conducted—

regarding uniform prices, rebates, and other selling conditions and that they have led to an agreement called selling conditions.[65]

Even though there may have been no formal comprehensive international agreement after 1938 or 1939, the "as is" principles were apparently of such a durable nature as to be regarded as trade customs, to be observed as the basis for subsequent arrangements in particular markets.

During the war years enemy-controlled markets were closed, shortages and rationing were general, exports were controlled by license,

[62] Standard Oil Co. (New Jersey) letter July 7, 1950, signed A. C. Minton, secretary. Clause 1 of the Draft Memorandum of Principles provided for termination of the agreement "by 1 month's previous notice, which may be given at any time."

[63] Swedish Oil Report (1947), ch. XII, p. 24, mimeographed translation.

[64] Ibid., p. 42.

[65] Ibid., pp. 42 and 44. At another point in the Swedish report this document was referred to as headed "Selling conditions as from January 1, 1947." After reviewing its terms at some length, the Swedish committee concluded that "the selling conditions must in our opinion be characterized as a price agreement" (ibid., pp. 26–28).

and formal cartel agreements were necessarily largely suspended. These conditions prevailed in some countries for varying periods after the termination of hostilities.

During the war period the leading American, British, and Dutch companies all cooperated closely in programs laid out by their respective governments to supply the oil needs of the Allied and neutral countries. These programs and the way in which the oil companies functioned in them varied in different Allied countries. In Great Britain, which became the seat of the Dutch Government in exile, the principal British, Dutch, and American oil companies operating in the United Kingdom formed by agreement what was known as the Petroleum Board.[66] This Board was described in the British trade press of the time as a voluntary private commercial body which had no direct connection with His Majesty's Government, but which, at the request of the British Government early in 1939, formulated plans to assure adequate supplies of motor fuel and lubricants with the utmost economy of transportation, storage, and distribution facilities, and manpower in case of emergency. Under this directive, two pooling plans were developed, one for motor fuels and one for lubricants. These pools were characterized as "by the industry for the industry." [67] Later, after the plan was approved and ordered into effect by the Government at midnight September 3, 1939, the Board's membership, according to the British Secretary of Mines, consisting of nine members representing—

> substantially the whole of the petroleum industry so far as it relates to the importation, storage, and distribution of oil products—

and its staff was drawn from all companies, both large and small.[68]

The Board, and the separate companies whose products it handled, had the responsibility for obtaining supplies from abroad, refining them, and getting them into the United Kingdom. There the Board, acting to all intents and purposes as a single marketing company, pooled all supplies and sold them through its likewise pooled wholesale distribution facilities. The pooled products were sold to garages, and to commercial consumers, much as the individual companies had previously done.[69]

The guiding principles underlying the operations of both the motor fuel and lubricating oil pools were described as the avoidance of waste and observance of the "as is" principle that "all concerns in the scheme

[66] The Petroleum Times, November 18, 1939, p. 531, states that the Board was formed originally by agreement among Anglo-American Oil Co., Ltd. (Jersey Standard); National Benzole Co., Ltd., Shell-Mex., and B. P., Ltd. (Royal Dutch-Shell and Anglo-Iranian).

[67] The Petroleum Times, October 28, 1939, p. 456, stated regarding these pools: "No new ministry controls the pools; no new Government department is set up; and no host of officials is recruited ignorant of the oil industry's special aspects. It is inevitable from the peculiar structure of the British oil industry that the few outstanding companies must predominate in any such schemes and their controlling personnel, but we know it to be correct that in the evolution of these plans the independents have rightly had their say, and now have their place in the wartime carrying out of the pools.

"Conceived in secrecy, these schemes have remained shrouded, even to this journal. Naturally, we have taken steps to remedy this deficiency in our knowledge, and the documents in our possession make it clear that much of this secrecy is unnecessary, and that the schemes are based on principles of ethics and fairness for all throughout; there is little that need not be revealed in full to the trade."

[68] Ibid., pp. 529 and 531.

[69] The motor fuel products covered by rationing, with which the Board had nothing to do except to collect and cancel coupons issued by the Government, included aviation spirit, motor spirit, benzole, kerosene, white spirit, gas oil, Diesel oil, fuel oil, and asphalt. The Board also supervised a lubricating oil pool which was operated separately from the motor fuel pool. The latter was described as purely an importers' pool which operated through a less extensive distribution organization to sell its pooled products in a similar manner. See Petroleum Times, November 18, 1939, pp. 530 and 531.

shall share alike in proportion to their stake in the industry during a prearranged qualifying period." [70] Beyond this, the functions of the Board had to do largely with import requirements, price fixing, and licensing.[71] Thus during the war and for more than 2 years after the cessation of hostilities, the Board's activities in the fields both of international supply and local distribution were carried on with the added force of Government sanction.

Much the same conditions continued to prevail after December 31, 1947, on which date the motor fuel and lubricating pools ceased functioning as part of the Government's wartime program, and products were again sold under brand names. Some of the functions previously performed by the Board were taken over by two new committees set up by the Ministry of Fuel and Power. Cooperating industry committees, acting with Government sanction, continued to function with respect to both supply and distribution. In reviewing the new postwar arrangements, the London Economist stated in August 1947:

> One committee will deal with * * * the supply of oil from overseas, the development of sterling area sources, tanker shortages, and the like. The second will deal with the supply, refining, and distribution of oil in this country. The new arrangements will also include a consumer's council with an independent chairman, representatives from the oil companies, and user industries and—for a less obvious reason—from the Trades Union Congress. Government control of prices, imports and petrol rationing will continue as before.[72]

The supply of petroleum products available to oil-importing neutral countries during the war was largely controlled by the British, American, and Dutch international oil companies, likewise acting in cooperation with their Allied Governments, while the local distribution of such supplies was subject to such regulation as might be imposed by the neutral governments. The only detailed study of cartel activities of representatives of international oil companies in a neutral country during the war and the early post war period is the Swedish Government's oil report cited above. These activities, together with such information as is available respecting activities in some other countries, are discussed in more detail in the next chapter.

SUMMARY

Four international oil agreements, dated from 1928 to 1934, and the oil industry's activities to implement these agreements through local cartels and in other ways, have been the subject matter of this chapter. The primary movers in all of these international agreements, and in efforts to implement them, were the three major international groups of the oil industry, namely, the Standard Oil Co. (New Jersey) group, the Royal Dutch-Shell group, and the Anglo-Iranian Oil Co., Ltd. (formerly Anglo-Persian Oil Co., Ltd.) group. Each of these is a completely integrated oil group consisting of a central controlling company and its subsidiary and affiliated producing, refining, transportation, and marketing interests. In addition, each of these groups is associated in interest with each of the others and, in some instances,

[70] Ibid., November 18, 1939, p. 529.
[71] Ibid., p. 530. This account states that under the licensing system which became effective on October 16, 1939, "any person other than the Petroleum Board who wishes to deal wholesale in petroleum products or benzole must obtain a license from the Secretary of Mines, the license to be subject to such conditions as to grade, quality, and price as the Secretary of Mines shall deem necessary."
[72] The Economist, August 23, 1947, p. 339.

with outside interests,[73] through joint ownership of reserves, through joint-control of producing, refining, and marketing facilities, and through agreements for the purchase and sale of crude oil and refined products.

The immediate background for the first international agreement in 1928 was a price war between Royal Dutch-Shell and Standard Oil Co. of New York in India in 1927, which promptly spread to the United States and European markets, where it severely affected, or threatened to affect, the financial interests of all major and minor companies. After this controversy was settled, the heads of the three major groups met and negotiated the Achnacarry agreement of 1928.

This agreement was essentially a declaration of principles and procedures by which the three majors hoped to forestall in the future similar outbreaks of competition, both among themselves and with others. The heart of this agreement was a group of seven principles to govern group action. These principles, collectively called "as is," were:

(1) Acceptance by the participants of their "present [1928] volume of business and their proportion of any future increase in consumption."

(2) Joint use of existing facilities.

(3) Construction of only such additional facilities as were necessary to supply increased demand.

(4) Production to retain the advantage of geographical location on the basis that "values of products of uniform specifications are the same at all points of origin."

(5) Supplies to be drawn from the nearest producing area.

(6) Excess of production over consumption to be shut in by producers in each producing area.

(7) Elimination of any competitive measures or expenditures which would materially increase costs and prices.

These principles were never formally abandoned. On the contrary, in subsequent agreements intended to implement them in whole or in part, "as is" was said to be of such a durable nature that failure of the subsidiary agreements to accomplish their objectives, or even their total abrogation by some parties, should not prevent further joint effort to find a basis on which to make "as is" effective.

In 1928, the world's principal developed reserves and production, outside of Russia and the United States, were largely controlled by the three participants in the Achnacarry agreement. The basic assumption underlying this agreement was that world production might be fitted to consumption and world prices thereby controlled if these companies (*a*) by agreement limited production and exports from the areas which they controlled; (*b*) found a way lawfully to control exports from the United States, where diverse ownership and the antitrust laws made direct control of production by agreement impracticable, and (*c*) found a way to control the competition of Russian oil in world markets.

Efforts from 1928 to 1930 were directed primarily toward controlling world production and supplies from all three of these sources. Private

[73] "Outside interests" is used here to designate integrated and nonintegrated companies outside the direct corporate control of any one or more of the three major international companies.

agreements to limit production were negotiated with outsiders[74] in some foreign countries. Russian competition, however, still continued to be troublesome, especially in European markets. In the United States, lawful ways of controlling production and exports were sought. The American Petroleum Institute sponsored proration of production in the late 1920's and sought both State and Federal sanction for its scheme as a conservation measure. This movement later developed into the system of interstate oil compacts sanctioned by the Congress as a conservation measure in the national interest. A few years later, the international companies similarly urged world-wide conservation as a justification for private agreements to limit production in foreign countries. Thus conservation became the cartel's slogan at a time when a rising flood of international production threatened to depress world prices.

In the United States, the conservation movement was supplemented in 1928 by the formation of Export Petroleum Association, Inc., as a lawfully constituted Webb Act association. This organization was to control American exports and fix the "f. o. b. Gulf" prices, which the principal international companies had agreed should be the base prices used in determining the value of oil products of uniform specification in all world markets. When Export Petroleum Association's members were unable to agree upon prices among themselves, due to foreign interference, and the legality of the proposed price-fixing activities was questioned, the association's activities collapsed in November 1930. Thereupon, the 1930 Rumanian agreement, the success of which depended upon the enhancement and maintenance of American export prices, also came to naught.

The experiences of the three principal international companies during the first 2 years of operation under the Achnacarry agreement were such as to make it clear that their control over the major sources of production outside the United States and Russia was, by itself, insufficient to serve as a basis for world-wide stabilization of the market. They could not always agree among themselves, and there was an increasingly important uncontrolled fringe of producers and marketers of various nationalities who were not bound by the main agreement. The activities of outside producers seldom were world-wide; but, by cutting even slightly under the cartel's prices in those markets in which they were interested, the outsiders became the beneficiaries of the cartel's program. If the cartel sought to drive such unwelcomed outside competition out of one market by price competition, the independents had the tactical advantage of being able to retaliate in other markets in which they previously had not been factors. The effort to stabilize the industry through a single world-wide agreement, therefore, demonstrated the difficulty of alining diverse interests under a single agreement, and the insufficiency of the dominant position of three companies in world production and distribution to serve as the basis for effective cartel controls in local markets.

The Big Three conferred late in 1929 in an effort to implement the principles of their 1928 agreement. The result was the Memorandum for European Markets of January 20, 1930, in which the three major international companies set out the terms upon which they agreed to act as a unit in attacking the problem of world control (*a*) through

[74] The Rumanian agreements of 1930 to 1932 are examples.

agreements among themselves and with others to control production in particular producing areas and (*b*) through marketing agreements involving themselves and others in particular consuming countries.

The first attempt under the expanded plan was the formation of a new Rumanian agreement in 1930, under which all Rumanian producers agreed to limit production and fix prices for oil from the Rumanian field. The success of this agreement hinged upon finding markets for Rumania's controlled production largely in European countries at prices satisfactory to Rumanian producers. As already indicated, the Rumanian agreement fell when Export Petroleum Association, Inc., was unable to agree on "f.o.b. Gulf" prices and became inactive. Thereupon, Steaua Romana, an affiliate of Anglo-Iranian, withdrew from the Rumanian proration scheme.

Concerted effort to bring Russian and Rumanian independent production under control and find a market for it at prices fixed by local marketing cartels formed in accordance with the 1930 Memorandum for European Markets, however, did not cease. Partial cooperation by the Russian trading company was obtained in some markets, and a new Rumanian production agreement was made in 1932, which the Rumanian independents signed only on condition that they be given a larger production quota than they would have been entitled to with the year 1928 as the base. This constituted a departure from the "as is" procedure previously laid out in the Achnacarry agreement. Furthermore, during 1930 to 1932 local marketing agreements to which outsiders were admitted proved difficult to conform to "as is" as set out in the Achnacarry agreement and the Memorandum for European Markets. This was so because of numerous concrete problems of procedure in sharing markets, fixing prices, making financial adjustments for under- and over-trading and adjusting quotas in markets where a participant entered a local market in which he had not previously sold, or where a participant acquired a previously existing independent outlet in a local market in which he already was selling.

The development of rules to solve these problems was attempted in a new international agreement known as Heads of Agreement for Distribution, which was adopted on December 15, 1932, at a meeting attended by representatives of Socony-Vacuum, Standard Oil Co. (New Jersey), Anglo-Persian, Shell, Gulf, Atlantic, and Texas.[75] The new agreement provided greater elasticity in the application of the Achnacarry agreement's quota provisions[76] by setting out in detail the manner in which the participants to the main agreement would contribute from their quotas in local markets to make room for larger production quotas granted to outsiders, as had been done in the case of Rumanian producers. Other revisions and additions made it clear that the revised international understanding covered the following points:

(1) That the principle of "as is" was to apply to every country or area of the world, except the United States.

(2) That it was to apply to supply (i. e., production and exports) and distribution of crude oil and refined products.

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[75] A representative of Sinclair Oil Co. was also recorded as having telegraphed his inability to attend.

[76] Both production and distribution quotas previously were based on the performance of the parties in 1928.

(3) That supply "as is" would be handled by a committee sitting in New York.

(4) That distribution "as is" would be handled by a companion committee sitting in London.

(5) That the activities of these two working committees would be coordinated through a central "as is" committee sitting in London.

(6) That all disputes arising under the Heads of Agreement would be decided by a central "as is" committee which would also provide rules for meeting problems arising as a result of new factors or changing conditions in the industry.

Thus machinery such as had not previously existed was provided for coordinating world-supply agreements among the major international companies with local marketing agreements to which outsiders were also to be admitted.

During the next year and a half, comparatively little was accomplished in further cartelization under the Heads of Agreement because, with American production uncontrolled, f. o. b. Gulf prices, which, by international agreement, were the base prices for computing European market prices, fell as low as 30 cents per barrel in May 1933. The disgusted independent Rumanian producers thereupon refused to observe their agreement to limit production, and shipped a few cargoes to markets as distant as Canada and Australia. Resistance to local marketing agreements based on "as is" also arose in European consuming markets.

Shortly thereafter, however, United States Gulf prices were advanced under the NRA Code of Fair Competition from 50 cents in July to $1 per barrel in October 1933, and became stabilized at that level. Thereupon, in February 1934, it was reported that the Rumanian producers were as willing as ever to control their production provided foreign production and prices were brought under control.

In the meantime, the three major international groups had tightened their joint control over reserves and production in Venezuela and the Middle East and continued their dominant position in Rumania and the Far East. The development of local market agreements became feasible again.

Past experience had demonstrated that although the "as is" principles might be strictly controlling with respect to relations among the Big Three, the diversity of interest of independents with whom these companies necessarily had to deal in local markets was such as to necessitate regarding those principles as ideals to be attained as far as practicable, but not to be insisted upon too strongly in dealing with outsiders. For this reason, as well as to clarify the positions of the principles with respect to each other, a new agreement known as the Draft Memorandum of Principles was negotiated in June 1934.

This agreement, the fourth, longest, and last of the prewar international understandings, was essentially a restatement of the "as is" principles of previous agreements. New material dealt largely with procedural amendments and detailed rules for the application of the principles in all markets of the world except the United States and any other countries where their application by agreement would be unlawful. The new rules dealt largely with special conditions under

which the application of "as is" had proved troublesome in the past. Specifically, it was agreed that—

(1) Local agreements to which outsiders were admitted were to be regarded as wholly separate from the draft memorandum, and outsiders were to have direct knowledge of the main agreement only to such extent as the London executives of the major parties might direct.

(2) In any market where all parties to the main agreement already were, or might subsequently become, members of a local cartel including outsiders, the major parties might unanimously agree that the local cartel would override the memorandum for that market for the duration of the local agreement.

(3) Two types of quotas for the participants were to be set up in each local market, one covering the total quantity supplied by each participant, including sales to other participants and approved outsiders, and the other covering only quantities actually distributed by each participant.

(4) Fines assessed against excessive overtraders were to be apportioned back to undertraders on a more equitable basis than had been provided under previous agreements.

(5) Quotas were to be adjusted for each of the following reasons:

(*a*) As a penalty against undertraders who, for any accounting period, refused to furnish to overtraders the quantities required to keep the quotas of all participants in balance;

(*b*) When new members were admitted to the local agreements;

(*c*) When a participant acquired an outside outlet by purchase;

(*d*) When a participant voluntarily retired from the market;

(*e*) When one product replaced another in use in the market (for instance, if Diesel fuel oil replaced gasoline).

(6) Under certain conditions specifically described, the general rule that price movements, either up or down, were to be governed by a majority vote of all participants in each local market was to be suspended, but even at such times, the practice of open price reporting and discussion of proposed prices in advance was to be followed.

(7) After a specified date no competitive expenditures for advertising and sales promotion and for capital investment for facilities were to be made except in accordance with budgets previously approved by the cartel's London committee.

This partial review of the various international agreements indicates that from the comparatively simple proposal of the Achnacarry agreement in 1928 to stabilize the world market by controlling production and exports there was evolved in 1934 an international agreement which contemplated detailed restriction of production, division of markets, price fixing, restriction on the number and kind of distribution outlets, and the elimination of competitive expenditures for market facilities and sales promotion in local markets.

So far as the record shows, the three prime movers in the formation of the international agreements, from Achnacarry in 1928 through the

Draft Memorandum of Principles in 1934, were the three major international companies. This appears to have been true even though some other important American companies sat in the conferences which formulated the later international understandings having to do with local markets. Jersey Standard, which appears to have acted as the leader among the American companies, states that it gave verbal notice of its withdrawal from the draft memorandum agreement in 1938, and that any activities which may have survived came to an end at the outbreak of the war in September 1939. From this, it might be inferred that cartel cooperation came to an end at the outbreak of the war.

However, British and Dutch cooperative relations were by no means severed with Standard's withdrawal, and American companies continued to cooperate to some extent both during and after the war. In the United Kingdom an industry committee, acting with the approval of His Majesty's Government, set up and operated a wartime pooling plan for international supplies and local distribution modeled quite closely along "as is" principles, and in Sweden, a neutral country, it was not until 1942 that American companies informed their subsidiaries that local agreements of the type made under the draft memorandum must no longer be made for the reason that they might be in violation of the American antitrust laws. Even then, cooperation did not entirely cease, for a Swedish investigating committee found that adjustment of under- and over-trading in accordance with "as is" was considered in 1943, and that in 1946 prices and terms of sale for the year 1947 were agreed upon.

More than 10 years of cumulative effort to operate and extend controls under the various international agreements apparently established acceptance of the durable nature of "as is" principles, so that their observance among the corporately interrelated international group became practically a custom of the trade.[77] The development of the cooperative atmosphere was favored by the intricate maze of contractual and other relations developed over the years among the small number of large international oil interests.

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[77] As early as 1936, when California-Texas Oil Co., Ltd., was formed after Standard Oil Co. of California had failed to reach an agreement with the Shell, Jersey Standard, and Anglo-Iranian groups for the marketing of Bahrein crude, the Petroleum Times, July 4, 1936, p. 8, summarized the situation as follows:

"From the standpoint of the two companies, the amalgamation is highly sensible, each complementing the other in its basic requirements [Standard had production, Texas had marketing facilities], while from that of world oil circles the advantage of the merger is that both companies being sound, stable, and conservatively managed, it assures that Bahrein production, as well as any output that may eventually come from countries now being developed by Standard of California, will have assured and regulated outlets and will so lessen any possible danger of upsetting the equilibrium of international markets."

CHAPTER IX

CASE STUDIES IN THE APPLICATION OF MARKETING AGREEMENTS IN SELECTED AREAS

The structure of control and agreement in the international petroleum market was made complete during the interwar period by the organization of local marketing cartels, based upon "as is" principles, in most countries of the world. The elements of this structure have been shown in the previous chapters of this book as including—

(*a*) The predominant and strategic position of seven international oil companies in the ownership of world petroleum reserves, production, refining capacity, and transportation facilities.

(*b*) Joint ownership by these companies in affiliated and subsidiary companies in all parts of the world, particularly in the Middle East, and in all phases of the industry.

(*c*) Crude-oil sharing arrangements in important producing regions.

(*d*) The development of agreement upon a philosophy and strategy of cooperation in marketing the end products of the industry. The local marketing cartels described in this chapter flowed naturally from these developments and provided an additional and important element in the structure of control and agreement.

This chapter, therefore, deals with (1) an examination of the procedure followed by the subsidiaries of the international oil companies in creating and maintaining local marketing cartels in accordance with the principles set forth in the international marketing agreements described in chapter VIII, and (2) an examination of the scope and effectiveness of the local cartels.

The marketing arrangements described in chapter VIII were, for the most part, general statements of policies and goals. They were designed to set up a broad and flexible framework of principles to be applied in each of the particular markets in which these oil companies were interested. The Achnacarry ("as is") Agreement, the Memorandum for European Markets, the Heads of Agreement for Distribution and the Draft Memorandum of Principles, therefore, did not directly allot quotas or fix the conditions of sale, but, rather, constituted guiding statements to be used in preparing and administering local arrangements to be put into effect for each petroleum product in each marketing area.

The international marketing agreements further provided that where the participants in the agreements were or intended to become members of local cartels, the local cartel arrangements would "override" the "as is" principles by unanimous consent. Thus the international agreements were highly flexible documents and the intention was to apply the agreed marketing principles, subject to special modifications or substitutions in the appropriate cases, to all countries

in which the international oil companies had marketing interests, except the United States.

The application of the broad agreements discussed in chapter VIII was effectuated only after a lengthy and continuous process of negotiation and consultation by local managements in each marketing area. It was necessary to agree upon marketing arrangements for each country, guided by the broad and flexible directives given in the international agreements. These local arrangements were to be governed, administered, and modified in the light of current conditions by the local officers of the international oil companies, who were directed to meet frequently for that purpose. Local administration was always subject to review by the London "as is" committee.

The lengthy process of preparing and administering the local arrangements is illustrated by the case of Sweden. Fairly complete information is available with relation to that country as a result of an investigation and report by a legislative committee in 1947. Sufficient information exists about other countries to indicate that the Swedish case history resembles that of other local cartels that operated under the terms of the international agreements in other foreign countries.

PROBLEMS IN THE APPLICATION OF THE AGREEMENTS

Certain broad economic and administrative conditions were generally influential in the creation and operation of the local cartels.[1] From 1928 to the beginning of World War II, they included conditions arising from (1) changes in the volume of consumption of petroleum products, (2) changes in the structure of competition, (3) the course and development of national economic policies, and (4) other matters.

Consumption of petroleum products

The period of gestation of the local marketing cartels coincided in time with the Great Depression, which began in some parts of the world as early as 1928. The incidence and impact of that depression, its intensity and duration, and the character and degree of recovery in the various national economies, all varied considerably from nation to nation. However, nearly all nations suffered sharp declines in the level of industrial production. The impact of the depression on the market for petroleum products, i. e., the demand in terms of physical volume, largely depended upon the operation of the following factors in each national market: (*a*) the extent of the decline and the speed of recovery in the level of industrial production, (*b*) the rate of development of new uses for petroleum products, which contributed powerfully to a long-term rising demand for the oil industry, (*c*) the prices charged for petroleum products, and (*d*) the nature and operation of national economic policies. These factors, of course, were interrelated. In spite of variation from country to country the following general observations may be made about the relation of the cartels to conditions of demand, the data on which they are based being given in the case histories discussed later in this chapter. (*a*) The market for petroleum products in most European countries expanded annually in the period 1928–36. The impact of the depression and related fac-

[1] A detailed analysis of these factors is beyond the scope of this study, and, in any event, much of the relevant information on activities in foreign countries is unavailable. Such specific information as is readily available is incorporated in the case studies given in this chapter.

tors was felt in some countries only as a slackening in the rate of increase, in others by slight declines in consumption lasting only a year or two at most.[2] (*b*) The market for petroleum products in most Latin-American countries declined considerably after 1929 and recovered rather slowly, reaching the earlier levels in most cases only in 1935 or 1936. (*c*) The international oil companies were able to form and maintain marketing cartels under all market conditions, whether of increasing or decreasing demand, and in agricultural economies as well as industrial. Their success, or, in some cases, lack of success, in holding or dominating markets was generally independent of the trend of demand. Control over the sources of supply was probably the most important factor in the outcome of these cartel ventures. (*d*) A slowing down or reversal of the long-term rising demand for products, which occurred in some markets, may well have been a resultant rather than a causative force in cartel operations. Successful cartelization with the attendant division of markets and fixing of prices and of selling conditions may have had an important effect in determining the course of consumption. While it is impossible to measure the effect of the marketing cartels upon consumption, there can be no doubt that the effect was restrictive. The information given in the Swedish case history, discussed in this chapter, is instructive on this point.

The structure of competition

The participants in the various national markets may be classified in the following general categories: (*a*) the "as is" group, (*b*) other major American oil companies, (*c*) the Russian oil monopoly, and (*d*) small competitors.

The "as is" group.—The subsidiaries of Royal Dutch-Shell, Standard Oil Co. (New Jersey) and Anglo-Iranian Oil Co. in each marketing area may be termed, for the purposes of this chapter, the "as is" group. This usage derives only in part from the fact that the parent corporations were leaders in the development of the international marketing agreements and held dominant strategic positions in the production of petroleum entering world markets. It also derives from the fact that in each country in which one or more of these three international oil companies held marketing interests, their local subsidiaries likewise held dominant or outstanding positions in the market and took the lead in the establishment of local marketing cartels. In each case study presented in this chapter, therefore, the relative position of the "as is" group will be discussed.

Other major American oil companies.—Marketing interests of varying importance in many countries, especially during the period from 1928 to the beginning of World War II, were also held by Texas, Gulf, Sinclair, Socony-Vacuum, and Atlantic. Representatives of all of these companies, except Sinclair, participated in the making of the Heads of Agreements for Distribution (1932) described in chapter VIII.[3] The cases studied in this chapter indicate that the marketing subsidiaries of these companies followed no consistent policy with respect to the many local marketing cartels that the "as is" group

[2] Germany suffered substantial declines in consumption of most petroleum products during 1931–33. In percentage terms, the products showing the greatest tendency to decline in consumption in all markets were kerosene, lubricating oils, and asphalt.
[3] See p. 241.

created and operated. In some countries these subsidiaries were participants in the cartels from their inception; in other countries they entered the cartels several years after they were created; in other cases they left the cartels after having been a member; and in still other cases they did not take membership. However, the fact that these local marketing subsidiaries did not always formally enter the cartels and accept quotas and other restrictions did not preclude cooperation with the cartel in the matter of prices and other competitive conditions.[4]

The Russians.—The greatest disturbances in European markets during the period under review were occasioned by the attempts of the Russian Government monopoly to capture portions of those markets. However, these disturbances were of limited importance, since the Russians were soon accommodating themselves to the cartel arrangements on both the international and national levels.[5] By 1929, for example, the Russians had entered into cooperative arrangements with the "as is" group of companies in Great Britain, and by 1932, in Sweden.[6] Having acquired small portions of many national markets by 1931, the Russians tended thereafter to be cooperative with the cartels.[7] By 1936 the Russians had sold out their interests or were in the process of withdrawing from the markets in nearly all cases.

Small competitors.—There were a great many small concerns competing in all products markets in all countries.[8] In Europe, for example, these small concerns included many domestic firms, usually subsidized or otherwise granted favors by their governments, which operated refineries and marketed their products domestically and in other European countries. Some of the most active of these were Rumanian and German concerns which had domestic sources of crude oil supply and thus were independent of the major international oil companies. In addition, there were many other small concerns, most of which appeared only in one or two petroleum product markets. Some of these were small domestic marketing firms that imported their supplies of refined petroleum products or purchased them from the local subsidiaries of the major oil companies. There were also numerous other purchasers or importers in each country, such as consumer cooperatives, large industrial consumers, joint purchasing agencies, municipal or other government consumers, and the like.

The competitive position of these small concerns may be summarized as follows: (*a*) These concerns were dependent for their supplies of refined products or crude oil[9] upon world markets dominated by the major international oil companies. (*b*) None of these small concerns accounted for more than a very small part of any product market, although collectively they often accounted for significant proportions, especially in such products as asphalt and road

[4] Furthermore, it seems unlikely that these subsidiaries could enter "violent competition" in one country without causing serious injury to the cartel structure in neighboring countries. There is no record of such events.

[5] See pp. 239–241 for discussion of Russian cooperation in the international sphere.

[6] The Russians also entered the German cartel in 1935. For details, see the respective case histories.

[7] According to the Petroleum Times, January 6, 1934, p. 12, the Russians, in accordance with their agreements with the international oil companies, reduced their exports of refined products in 1933 by 22 percent from the levels of 1932. "All goes to show that there was no flood of Russian oils in world markets last year."

[8] These comments are directed chiefly at European market conditions. There is less information available with respect to Latin America, and in most cases there is insufficient information to show how important small concerns are in these markets.

[9] Except for the Rumanian and German refiners having domestic supplies of crude oil.

oils. (c) The major international oil companies maintained a close watch and control over the activities of these small importers and sellers. As the Swedish case history indicates, no firm was too small or insignificant to escape their attention, control over supplies being an especially potent weapon.

National economic policies

During the interwar period, nearly all countries, and particularly all European countries, developed extensive and complicated programs of economic controls. These included high tariffs, import quotas and other trade barriers, currency and exchange restrictions, subsidies, protective legislation favoring home industries, and a host of other devices intended to combat the depression, develop and promote domestic industries and markets, and, in some cases, make the Nation more self-sufficient in case of war. Difficult problems often arose as a result of such legislation, which hampered the application of the principles set forth in the international marketing agreements. One official of the Standard Oil Co. (New Jersey) stated the problem as follows:

> Besides the day-to-day problems of handling the marketing of the three companies [i. e., the "as is" group] more or less as *a joint venture*, we are now confronted with nationalistic policies in almost all countries, as well as decidedly socialistic tendencies in many.

He then proposed that the parent corporations' marketing organizations be "domiciled in the same place" to insure the "best results," if these problems "are to be *harmoniously* acted upon."[10] In other words, the "joint venture" of Shell, Standard (New Jersey), and Anglo-Iranian in Europe and South America extended not only to "the field of pure marketing" but also to cooperative dealings with governments. By means of "*daily contact* of the managements of the three interests," therefore, the "as is" group would have unique power in these dealings with foreign governments.[11]

Other problems

Generally, the other problems met in the shaping and direction of the local marketing cartels were those usual in such cooperative undertakings, including such matters as the problems of cooperation among the separate enterprises, of bringing into the cartels and holding the most important competitors, of controlling the activities of outsiders, of successful operations by a number of cooperating concerns under the necessary conditions of secrecy, and so on. All of these problems are well illustrated in the Swedish case history. To these may be added the fact that the managing directors of the marketing subsidiaries of the "as is" companies were adjured to maintain secrecy with regard to the international marketing agreements. Thus, their staffs operated without knowledge of the subject matter and provisions of their basic directives, and the other participants in the cartel arrangements frequently entered into cooperation without knowledge of the "guiding principles" upon which these agreements were founded.[12]

[10] Italics added. Memorandum, dated January 19, 1935, and initialed OM (probably a misprint of OH, i. e., Orville Harden), printed in Patents, hearings by Senate Committee on Patents, 77th Cong., 2d sess., 1942, pt. 7, p. 3683.
[11] Ibid. Italics in original.
[12] See pp. 248 and 255.

CASE STUDIES

Sweden

In 1947 a special investigating committee reported to the Swedish Riksdag that petroleum-product cartels, organized and operated in accordance with the principles set forth in the international marketing agreements described above in chapter VIII, had been in existence in Sweden during the decade of the 1930's. It reported that the participants in those earlier cartel agreements were then (1947) attempting to organize new cooperative arrangements. The Swedish case history presented in the following pages is largely based on this committee's report. This history forms a significant episode in that it illustrates the manner in which the international oil companies shaped the "as is" principles to fit the requirements of particular local markets. Moreover, this detailed study imparts meaning to the less-well-documented case studies that follow.

The Oil Investigating Committee of 1945.—One of the functions of the Oil Investigating Committee of 1945 [14] was to investigate oil enterprises in Sweden in accordance with the law on investigations regarding monopolistic enterprises and associations.[15] In accordance with its directives, the committee made an extensive inquiry and submitted its report to the Riksdag in 1947. The principal findings of the committee with respect to the oil enterprises in Sweden was that these firms had made a number of agreements respecting prices, sales conditions, sales quotas, and so on, during the 1930's, all in accordance with the principles of the "as is" marketing agreements, and that there was some evidence that this cooperation was being revived.[16] The committee also reported that the oil companies had attempted to obstruct and mislead the committee in its inquiry and had objected vigorously to publication of the report.

A summary of cartel arrangements, 1930–47.—It is not clear that the 1928 "as is" agreement was immediately followed by consultations and cooperation in Sweden, but such activity did immediately follow the negotiation and conclusion of the Memorandum for European Markets in 1930. Renewed and accelerated activity among Swedish oil concerns followed the agreement by the parent corporations upon a Draft Memorandum of Principles. The cancellation of this memorandum did not mean the end of cooperation in Sweden. The Swedish Oil Committee found evidences of continued collaboration up into World War II and of an attempt to revive the "as is" principles in the postwar period.

In the pages that follow, Swedish cartel arrangements are described in accordance with this chronological outline. A discussion of the application of the arrangements in markets will be presented in a later section.

Cooperation in the 1930–33 period: During the early period, the leading oil companies on the Swedish market, that is, the local sub-

[14] Appointed pursuant to authorization of the Riksdag of Sweden in 1945. Its principal duty was to undertake a survey and submit proposals regarding state control of the importation of and trade in certain petroleum products.

[15] This statute authorizes investigations of monopolistic enterprises and associations to determine the influence of such organizations on price or sales conditions in Sweden and grants to the investigating authority powers substantially the same as the right of subpena by congressional committees in the United States. See the preface to the report of the committee.

[16] This case history is largely based on ch. XII of the report, which is the source of all information except that specifically credited to other sources.

sidiaries[17] of Standard (New Jersey), Shell, Anglo-Iranian (BP), and Texas, arrived at two principal agreements and several supplementary agreements.[18] Separate agreements or understandings were made with Nafta (owned by the Russian oil monopoly) and with Nynas, a Swedish refiner, importer, and marketer of petroleum products. In 1931 these six firms actually accounted for 97 percent of the market in those petroleum products covered by the principles of the "as is" agreement.[19]

The four international oil companies began negotiations in the fall of 1930 and were successful in arriving at a working agreement, i. e., "rules of life," in April 1931. These rules consisted of a "principal" agreement and two supplementary acts known as the "sales act" and the "community act."

The "principal" agreement set forth the terms under which the companies were to cooperate. Among other matters the parties agreed: "*to observe strictly the prices and other selling conditions* that were fixed by the parties from time to time for the sale of benzene, kerosene, and gas oil in Sweden";[20] "to create mutually a fair distribution of the trade in these products"; and "to cooperate with a view to cutting sales expenses as well as the costs of distribution and organization." They also agreed to cooperate in "acquiring for themselves and keeping" their customers in Sweden.

The "sales act" included specific stipulations regarding conditions of sale and delivery, while the "community act" contained detailed agreements concerning the division of trade, rationalization of operations, and similar matters.[21]

In May 1932, the representatives of Standard, Shell, BP, and Texas concluded a further agreement pledging "full cooperation" among the parties in the future "for the purpose of bringing about better and sounder conditions on the Swedish oil market." This agreement, which was more formal than the earlier one in that it was actually signed by the representatives of the companies, established joint terms of rebate and provided for collaboration with respect to the erection of new service stations. Subsequent agreements regulating selling conditions were arrived at during a number of later meetings.

During the negotiations leading to the agreement of April 1931, representatives of the Swedish subsidiaries of Standard and Shell arrived at an agreement with the most important Swedish firm in

[17] The following terms will be used in referring to the principal Swedish oil firms, including their predecessor and affiliated companies:

(*a*) Standard (New Jersey)—Standard Swedish Petroleum Co.
(*b*) Shell—Swedish Shell Co.
(*c*) BP—BP Swedish Gasoline & Petroleum Co. (owned by Anglo-Iranian Oil Co.).
(*d*) Texas—The Texas Co.
(*e*) Nafta—Aktiebolaget Naftasyndikat (owned by the Russian state oil monopoly and sold to Gulf in 1937).
(*f*) Gulf—Swedish Gulf Oil Co. and Alfred Olsen & Co. (a Danish affiliate of Gulf). For further information about Alfred Olson & Co. (see p. 284, footnote 31).
(*g*) Nynas—Nynas Petroleum Co. (a Swedish concern (see p. 696, footnote 3).

[18] The committee presented a summary of the information on these agreements that was given in 1933 in a report by a predecessor committee, the Committee of Motor Fuel Experts.

[19] I. e., substantially all petroleum products that are domestically consumed, with exception of lubricating oils and specialty products (see p. 289). The percentage figure is derived from data given in tables 15 and 16, pp. 302–303.

[20] These terms generally cover all petroleum products included under the "as is" agreement except asphalt and road-making materials. [Italic added.]

[21] While the three agreements were not signed by the representatives of the oil companies, "the stipulations are said to have been adhered to in the main, though alterations have been made here and there by special decisions, and in some respects there have been differences of opinion."

the petroleum market, Nynas Petroleum Co.,[22] concerning the sale of bitumen, benzine, kerosene, and gas oil—in short, all of the products covered by the "as is" principles. No details of this agreement are given, except that it was provided that the agreement was effective up to and including December 31, 1933, and was to be automatically extended annually unless either party gave notice of its termination.

The largest and most vigorous competitor of the principal oil companies in Sweden during this early period was the subsidiary of the Russian Oil Monopoly, the Naftasyndikat.[23] In the autumn of 1932, negotiations were opened with Nafta to eliminate the keen competition between the oil companies and Nafta, which had resulted, it was said, in unprofitable prices and financial losses to all concerned. It was reported that these negotiations resulted in "collaboration" between Nafta and the oil companies, and that Nafta, upon being informed of the agreements that the others had mutually made, had applied the conditions of sale the oil companies had agreed upon but had not entered into a formal agreement to that effect. This collaboration resulted in higher benzine prices, and the stabilization of retail prices was made possible, although Nafta continued to grant higher rebates in some cases than the others. The committee did not report, nor did the oil companies assert, that the Russians caused any further disturbances in the market; and it may be assumed that this "collaboration" continued until Nafta's business was taken over by Gulf in 1937.[24]

Agreements under the Draft Memorandum of Principles, 1934–38: The preparation of a new and far more elaborate international agreement, the Draft Memorandum of Principles,[25] together with its addenda and explanatory notes, necessitated the conclusion of new local agreements in Sweden. Six agreements, memoranda, and the like were found by the committee to have been entered into by the oil companies in Sweden during the life of the international Draft Memorandum of Principles, that is, during the period from 1934 to 1938. These documents, as will become evident, follow a logical sequence of development, and culminate in the most important Swedish agreement, that of October 15, 1937.

The representatives of the "as is" group of companies—Standard, Shell, and BP—signed a joint memorandum, written in English, and dated October 6, 1934. In this memorandum, the representatives noted that they had each gone through the Draft Memorandum of

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[22] The agreement was actually made with A. Johnson & Co., the parent corporation. Johnson imported crude oil and operated a refinery at Nynasham, while Nynas marketed the refined products, chiefly asphalt and road oils, in Denmark and Norway as well as in Sweden. Johnson's refining capacity in 1929, the year in which the refinery was constructed, was 40,000 metric tons annually; this capacity was doubled in 1931 and a cracking plant was added; and in 1939–40, with the aid of a Government loan, the capacity was expanded to 600.000 metric tons annually. Nynas' share of the Swedish market in 1931 was 3.83 percent and in 1936, 3.90 percent. See the Swedish report, ch. V, pp. 14–15, and table 15, p. 302, below.

[23] "Violent fluctuations" in prices, competitive rebates, and considerable financial losses by the Swedish subsidiaries of the oil companies were attributed to their struggle with Nafta. During 1930–32, these concerns created an interest-bearing debt with the parent corporations of 35,201,260 kroner. (The total debt of the companies increased slowly during the 1930's to a peak of 48,212,276 kroner, which was 85 percent paid by 1945.) On the other hand, Swedish fuel oil experts have contended that declining prices in Sweden during the 1928–32 period were largely caused by declining prices in the world market, due to declining costs; that, while the subsidiaries lost money, the parent corporations had substantial profits; and that petroleum products could be purchased in world markets, during this period, at lower prices than those charged the subsidiaries by the parent corporations. See ch. V, p. 1, and ch. X, pp. 8–10 of the Swedish report.

[24] In addition, Nafta was a party to the "price system" agreement of February 10, 1936. See p. 284.

[25] See pp. 253–265.

Principles and its explanatory notes, that they herewith noted down the decisions they had agreed upon in those matters left open for local agreement, and that the application of the quotas for 1934 raised certain questions—due to a previous agreement to increase BP's quotas—that would be referred to the head office for instructions. The memorandum apparently indicated, therefore, that the three subsidiaries had accepted the Draft Memorandum of Principles as a basis for local agreements.

A memorandum was prepared at a meeting on November 19, 1935, of Standard, Shell, BP, and Texas, and deals principally with "irregular customer's terms," i. e., the fact that the terms of sale to customers were not uniform. The parties agreed to try to correct "the chaotic conditions that characterized the market,"[26] and thus to reach "the peace which must absolutely form the basis of a measure *aiming at a stabilization of prices*," [27] As soon as the program decided upon in this memorandum had "noticeable results," a "definite program for a continuing stabilization of prices" would be drawn up. Specific measures agreed upon included: (1) the existing distribution of customers would be honored and participants would not try to acquire one another's customers; (2) uniform rates of rebate set forth in the memorandum would be applied, and fixed rebates for certain large consumers, such as railways, municipal institutions, highway boards, etc., were agreed upon; (3) an investigation of the "group resellers-consumers" would be made to ascertain to what extent they could be distinguished as "resellers" (retailers) and consumers, and maximum permissive rebates were fixed for the latter when buying in bulk; (4) regulations for compensating a participant which had lost a customer to other participants were agreed upon;[28] and (5) the parties agreed to set up a "special control committee." It was also decided at this meeting that Nynas would be invited "to attend the meetings of the committee."

A memorandum, dated January 31, 1936, set forth in summary form a "price system" which was put into effect on February 10, 1936. The adherents to this "price system" included Standard, Shell, BP, Texas, and Nafta. The latter appears in a formal agreement for the first time.[29] Uniform "rebates, bonuses, and terms of payment were fixed for various categories of consumers, such as private motorists, municipal institutions, road contractors, private railways, and automobile firms." Special rebates and other stipulations were agreed upon for highway boards, state unemployment commission, purchases by the state, and deliveries to the IC,[30] the Stockholm Tramways, and other large or special purchasers. This "price system" seems to be, at least in part, the "definite program for a continued stabilization in prices" mentioned in the memorandum of November 19, 1935.

[26] It is difficult to comprehend exactly what is meant by this phrase since the earlier agreements had apparently eliminated most forms of price competition by the end of 1932. It may refer to practices of "chiseling" or shading of prices and terms of sale.

[27] Italic added.

[28] The losing participant was entitled to make up his loss by selling an equivalent volume of product at agreed upon prices to the participants who had gained the customer, and was entitled to receive an equivalent customer as compensation. This provision suggests that this agreement, which is given in the Swedish report only in summary form, closely approached the "as is" principles in many respects.

[29] Nynas, in accordance with the invitation extended to it in November 1935, probably sat in on the negotiations leading to this agreement, and, in any event, as is shown in the paragraph following in the text, was a full collaborator in its elaboration.

[30] The IC organizations were purchasing cooperatives of automobile owners, including especially among its members owners of taxis and motor lorries.

The "price system" set forth in the memorandum of January 31, 1936, was elaborated in considerable detail as a result of decisions made at meetings of the companies during June and July 1936, and recorded in an undated memorandum. Participants in these meetings included Standard, Shell, BP, Texas, Nynas, and Gulf. With the inclusion of the latter company at these meetings, all Swedish oil interests of any consequence were included.[31]

The purpose of the meetings was to shore up the "price system" which was threatened by the pricing and selling practices of "some resellers and distributors" who had not "adhered to the stipulations regarding rebate-granting." These practices were—

> beyond the control of the participants [in the agreements], and, in consequence, the rebates having lately shown a tendency to spread, the parties decided[32] * * * *that the resellers should be deprived of the right to grant and pay rebates and that the term "rebate" should be eliminated from the market.*[33]

While the details of this agreement are too lengthy, even in summary form, to be reproduced here, the trend and tone of the document are well illustrated by a few citations. Thus, for example, the "official" price of benzine and bentyl[34] was reduced, but this was made up by an agreement upon "new price zones" and by removing all cash discounts paid to consumers and the rebate paid to "commercial traffic." The parties also agreed to reduce the "reseller's" margin by a stipulated amount and to protect "loyal resellers" by *cutting off deliveries* to those who failed to observe all the stipulations set forth in the agreement. The wealth of detail in this agreement is illustrated by the decision that "free service or washing and lubrication at reduced prices must not be applied at the companies' stations, but *the fixed service prices should invariably be charged.*"[35] Numerous other provisions dealt with such matters as the classification of customers, special terms of sale and price for the special categories of customers, and so on.

On January 25, 1937, representatives of Standard and Shell signed an agreement regarding deliveries of "black oils" (bunkers and other heavy oils) to the Royal Navy and the Royal Board of Waterfalls. It was decided that the two companies would divide all such State deliveries of 100 metric tons or more between them, while deliveries of less than 100 tons would be placed among Standard, Shell, BP, and Texas in accordance with a previous local agreement. Certain other matters were referred to London for decision.

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[31] Gulf had been a marketer of gas and fuel oils in Sweden since the early 1930's through its affiliate, Alfred Olson & Co. (see below p. 820), and had attended regular weekly meetings of the group as early as January 1936 (see pp. 292–293). Gulf was a participant in the meetings of June and July 1936, not only through this connection, but also because it was probably then negotiating with Nafta for the purchase of Nafta's marketing organization, the sale being concluded on May 1, 1937. This would explain Nafta's absence from the meetings. With this sale, the Russians apparently withdrew from the Swedish market.

[32] The decision was made only after "the political situation" and "all questions of topical [current] interest" had been thoroughly gone into. This reference probably refers to the fact that the third investigation of the oil trade in Sweden in the 1933–36 period was then in progress. (From the point of view of their impact on the conduct of the oil business, all three reports were negative; see ch. V of the report, passim.) During the summer of 1936, the Swedish Government had a change in administration which was also probably considered in the making of the decisions.

[33] Italics added.

[34] Probably a motor alcohol blended with benzene and produced as a byproduct of the sulfite pulp industry of Sweden.

[35] [Italics added.] Distributors—i. e., company agents—who failed to observe this stipulation or any of the others in the agreements were to be given "a clear warning," and if the infractions persisted, the errant distributor was to be "immediately discharged from his post."

The agreement that bore closest resemblance to the international Draft Memorandum of Principles was signed on October 15, 1937, by representatives of Standard, Shell, BP, Texas, and Gulf. This is the first document uncovered by the Oil Investigating Committee that allocated domestic sales quotas and provided for adjustments for over- and under-trading. The purpose of the agreement was stated in much the same terms as in the Draft Memorandum of Principles itself, and adds nothing new. The agreement was to cover the period from October 1, 1937, to December 1, 1938, and was to run automatically from year to year thereafter unless notice in writing was given by any participant not later than September 30 of any year.

While this is the first document found by the committee that specifically set forth distribution quotas for the five companies—Nynas did not participate in this agreement—the committee had evidence from other documents that the "as is" group, at least, had had such arrangements between them in earlier years.[36] Details on the actual quotas that were agreed on are given below in the discussion of the application of the agreements.

The Swedish "as is" agreement likewise included provisions for the adjustment of over- and under-trading which, for the most part, accord with the procedure set forth in the Draft Memorandum of Principles,[37] although there were some changes. These provisions, together with those relating to distribution quotas, are examined below in the discussion of the administration of the cartel arrangements.[38]

Other provisions of this Swedish "as is" agreement of 1937 included nothing novel. It was agreed that "uniform selling prices and terms" were to be maintained; although special prices and sales conditions were agreed upon for the special categories of customers mentioned in earlier agreements, these were to be eliminated at the time that new contracts were being negotiated.[39] The parties agreed to respect each other's customers. They also agreed not to supply "other competitive marketers," except by agreement, whereupon all the parties were to share in this business pro rata to their quotas; nor to sublet any part of their storage facilities to such outsiders or to associations of consumers.

In addendum 5 to the Draft Memorandum of Principles certain stipulations are made with respect to economy in competitive expenditures. These stipulations were the subject of a meeting on January 17, 1938, attended by Standard, Shell, BP, and Texas. The decisions that were made were recorded in a memorandum, and a committee of representatives of each company was formed to meet monthly for discussions of "relevant problems." It was decided that the total number of "selling points" would not be increased in 1938, and that extension and reconstruction of existing service stations would be

[36] The independent information presented on pp. 741 ff., confirms this conclusion of the committee. No evidence was given by the committee to show that Texas participated in any of the earlier quota or other special "as is" arrangements, while Gulf was substantially a newcomer to Swedish markets. While Nynas did not participate in this agreement, it was already as "as is" adherent for asphalt, by far its most important product (see p. 300 below).

[37] See above pp. 253–265.

[38] See below p. 297 ff.

[39] In the case of certain benzene customers, Gulf was allowed to offer "terms deviating from the official ones" in order to "protect their old customers" which they had inherited from Nafta. However, these "special terms," in each individual case, were to be submitted to the companies for discussion. Gulf was also allowed generally to grant extra rebates and discounts, which were fixed in the agreement, but was not to use these "temporary concessions" for "securing new business."

limited to lists especially prepared as enclosures with the memorandum. No company would install a meter at a selling point from which another company had removed one, and no company would encourage resellers or consumers to erect service stations at their own expense or would contribute to such building by making money contributions, paying rent, etc. The companies also agreed not to extend their current capacity in stationary plants or bulk vessels.

Draft and agreements, 1939–47: Insofar as formal documents are concerned, cooperation in Sweden reached its fullest development in the agreements of 1936 and 1937. When the time came for renewal of the agreements early in 1939, this proved to be difficult because the subsidiaries of Gulf and Texas were not able to sign. This was probably due to developments in antitrust activity in the United States. In chapter VIII, the possibility has been shown that the international Draft Memorandum of Principles was canceled for this reason early in 1938.[40] The dissembling nature of this cancellation is revealed in a letter sent to one of the Swedish concerns by its foreign parent company, which was made available to the Oil Investigating Committee.[41] The subsidiary enterprise was notified in April 1939 that the international draft memorandum had been "formally" canceled for reasons which it was not necessary to state. The committee's paraphrase of this letter continues:

> However, the intention had not been that the basis of the cooperation should, in reality, be changed. The only actual alteration was that, while the draft memorandum had been a document which had been generally applicable in all countries, *matters must now be so arranged that the companies in each country had to reach their own agreement on about the same lines as the draft memorandum* but with the modifications which had proved to be necessary for an adaptation to local conditions. *Thus an agreement ought now to be made which superseded the draft memorandum in respect of the relation between the three large companies in Sweden.*[42]

The situation at the beginning of 1939, therefore, was that while Texas and Gulf were not able to sign formal documents, the "as is" group, including Standard (New Jersey), Shell, and BP, were prepared to go ahead with new agreements that were to take the place of those based on the draft memorandum.

While the outbreak of World War II put an end to most private cooperation in Swedish industry, the Oil Investigating Committee discovered evidences of a revival of cooperation in the postwar period. The following paragraphs summarize the comments of the committee on oil industry cooperation from 1939 to 1947.

Negotiations for a renewal of the Swedish "as is" agreement of 1937 or for the conclusion of a new agreement were carried on at the end of 1938 and at various times in 1939. In a memorandum dated December 29, 1938, and signed by representatives of Standard, Shell, and BP, it is mentioned that these three companies and Texas had agreed that a new local agreement should be concluded. This memorandum states that unless Texas' and Gulf's replies regarding the new agreement were given by January 1, 1939, the life of the 1937

[40] See p. 206.
[41] The Government would not permit the committee to give the names of the sender or receiver of "personal" letters or to copy them, either in full or in part, but a paraphrase or summary of the contents was permissible. Presumably this letter was sent by one of the three signatory companies of the draft memorandum, i. e., Standard, Shell, or Anglo-Iranian.
[42] Italics added.

agreement would be extended to January 31, 1939, presumably to permit negotiations to continue. However, Texas refused to sign a "price list" prepared for 1939 on the grounds that it was not allowed to sign joint statements.[43] Similarly, Gulf refused to sign a draft, dated January 9, 1939, which provided similar terms for economy in competitive expenditures to those in the memorandum of a year earlier. The other four parties nevertheless agreed to mutually apply this agreement, and to exchange lists regarding their plans for expenditures in 1939. Despite these difficulties, negotiations continued, and a draft of an agreement was prepared, dated February 6, 1939, which substantially repeats the provisions of the 1937 agreement. This draft apparently was never signed, although the names of the five companies were typed under the text; and the Oil Investigating Committee concluded that it had never been applied.

Nevertheless, the "as is" group—Standard, Shell, and BP—were agreed that efforts should be made to arrive at new agreements. Representatives of the three companies signed a memorandum,[44] dated June 1, 1939, which stated that the provisions of the existing agreement between the five companies could not presently be "improved," but that the three signatories would prepare a new agreement covering all products and submit it to the parent corporations in London for approval. They agreed to operate on the basis of the new three-party agreement should the existing five-party agreement cease.[45] As a result of this memorandum, an undated first draft[46] of a three-party agreement was prepared which generally followed the pattern of the agreement of October 15, 1937, and of the Draft Memorandum of Principles, except that a revision in quotas was to be made due to special arrangements among the head offices in London. Presumably this matter was not pursued further because of the outbreak of World War II.

During World War II the petroleum market was, of course, subject to special controls and abnormal conditions of supply, so that a study of this period would be beyond the scope of this report. The Oil Investigating Committee was satisfied, however, that even during this period some degree of the earlier cooperation had been carried on. They report that they had established by a study of Shell's correspondence "that, as late as 1943, some companies in Sweden had discussed an adjustment of over and under deliveries."

Maximum prices for petroleum products in the Swedish markets were fixed by a price control board in the postwar period. During negotiations with this board concerning proposed reductions in the price of benzine, the oil companies also had negotiations among themselves about some proposed "rules of life" with regard to rebates and selling conditions. These proposed stipulations were recorded in a draft document which was headed "Selling conditions as from January 1, 1947." It was proposed that all contracts and other delivery

[43] However, Texas was a signatory to the 1937 agreement, which was, as noted in the text, still in force.

[44] In a letter dated June 2, 1939, the contents of this memorandum were made known "to the international committee of cooperation." No description of this committee is given, but it may be surmised that this refers to some committee of the London marketing offices of Standard, Shell and Anglo-Iranian, perhaps the supposedly defunct "as is" committee.

[45] This style of expression suggests that the 1937 agreement did not in fact terminate on January 31, 1939.

[46] This draft was attached to a letter dated August 24, 1939.

agreements for certain petroleum products be based on the "official selling price" prevailing on the date and at the place of delivery, i. e., that all the companies charge the maximum prices allowed by the price board. Rebates for the different classes of suppliers (i. e., retailers, etc.) and consumers were to be fixed at stipulated figures and all current contracts and delivery agreements with higher rebates than those stipulated were to be terminated before December 31, 1946. The products covered under the proposed rules include motor spirit, lattbentyl,[47] water white illuminating kerosene, power kerosene, gas oil, fuel oil, and white spirit. It was also proposed that all cash discounts be eliminated, that compensation to resellers and consumers for rent of their service station and plant be put at a fixed sum per litre, that bonuses for quantity purchases be fixed, that all expenses for the operation of service stations be borne by the station managers, that no extra terms be granted to State and municipal institutions, and so on.

There was some dispute with the companies as to whether these "rules of life" were being applied and whether they constituted a price agreement. In the opinion of the Oil Investigating Committee the rules did constitute a price agreement since these provisions were all in addition to, and arrived at separately from, the "official" price set by the price board.[48] When a representative of Shell protested that this was merely a "draft agreement," it was proved by the committee that Shell itself had ordered the application of these selling terms. The committee does not state whether other concerns had applied these "rules of life."

The committee's characterization of this document as a "price agreement" has interesting implications with respect to the position of Standard, Texas, and Gulf. Although these companies had each protested at some point in the investigation that their instructions from their parent corporations would not permit them to enter into joint agreements affecting prices and otherwise conflicting with the American antitrust laws, all three had participated in the negotiations leading to this agreement.

Administration of the cartel arrangements.—In the preceding pages, an account has been given of the cooperative arrangements developed by the oil companies in Sweden during the period from 1930 to 1947. The pattern of these arrangements shows a continuous process of broadening and elaborating cooperation in Sweden up to the eve of World War II, and it shows an attempt to reconstruct this cooperative pattern in the postwar period. In the pages that follow a summary analysis is presented of the method and the scope of application of these agreements.[49]

[47] For a definition of "lattbentyl" see p. 284, footnote 34.

[48] The State price control board stated that they had no part in drawing up these "rules of life" and that their sole function was to fix maximum prices. Addendum to ch. XII of Swedish Report, p. 16.

[49] Two primary sources of information are drawn upon in this summary analysis. One consists of documents taken from the files of the Standard Oil Co. (New Jersey) which present in summary statistical form the results of "as is" operations in Europe from 1928 through 1936. These documents are known as the Deliveries Into Consumption—Europe. It may be noted at this point that these do not purport in all cases to record all cartel-like activities in each country but were intended primarily as a record of the operations and relative positions of the "as is" companies—Standard (New Jersey), Royal Dutch-Shell, and Anglo-Iranian. The other primary source of information is that afforded by the report of the Swedish Oil Investigating Committee of 1945. This report describes the application of the various agreements in Sweden in some detail, especially for the years 1937 to 1940. It affords an intimate view of these operations that is available for no other country.

The marketing arrangementments and agreements in Sweden generally were applicable to nearly all petroleum products sold for domestic consumption. These "controlled products," which were essentially the same as those governed by the international "as is" agreement,[50] were classified as follows:

(*a*) Benzine (i. e., gasoline and closely related solvents).

(*b*) White spirit (i. e., turpentine substitutes and the like).

(*c*) Water white or illuminating kerosene.

(*d*) Motor or tractor kerosene.

(*e*) Diesel oil (excluding bunkers).

(*f*) Gas oil (i. e., a wide variety of fuel and other heavy oils, excluding bunkers).

(*g*) Automotive gas oil[51] (i. e., gas oil grades used as motor fuel).

(*h*) Asphalt (i. e., asphaltum oil, black oils, fluxes, residual oils, and all other petroleum products used as road-building materials).

The Swedish cartel arrangements did not include bunkers[52] or specialty items such as petrolatum, paraffin waxes, candles, and so on. Insofar as these local arrangements are concerned, there were no provisions reported by the Oil Investigating Committee relating to lubricating oils.[53]

The total volume of petroleum products consumed in the internal or domestic market in Sweden, therefore, included all the "controlled products," lubricating oils, and specialty items. In 1936, the last year for which market statistics were compiled in the Deliveries Into Consumption, the total deliveries of "controlled products" and of lubricating oils were 832,231 metric tons. As to specialty items, while consumption statistics are not available, net imports in 1936 were about 6,500 metric tons.[54] Assuming that these imports were equivalent to consumption, total consumption of petroleum products in Sweden for domestic purposes was about 838,750 metric tons in 1936.[55] Thus, the proportions of total domestic consumption were: for "controlled products," about 93 percent; for lubricating oils, about 6.5 percent; and for specialty items, less than 1 percent.

[50] See p. 256.

[51] Automotive gas oil was segregated in a separate category, effective January 1, 1936, in accordance with a directive in the Draft Memorandum of Principles. (See p. 260 and footnote 42, p. 261.)

[52] Bunkers include all oils put aboard ships for fuel and power purposes, except for those consumed in internal commerce by tugs, fishing boats, and other coastal vessels, which are included above. (See p. 580.)

[53] In a survey of the Swedish petroleum market, for the calendar year 1939, H. Carlson, American vice consul in Stockholm, stated the following: "As regards lubricating oils, there is another organization called * * * (The Association of Swedish Importers of Lubricating Oils). This association controls the prices of lubricating oils sold in Sweden and consists of the above large oil importers and several wholesalers, who import themselves and also buy from the large importers" (International Petroleum Trade, September 30, 1940, p. 358). The "large importers" referred to include the six principal companies operating in Sweden at that time. (See p. 694, footnote 1.) The document Deliveries Into Consumption—Europe includes detailed marketing statistics for lubricating oils for Sweden, and for nearly all European countries, compiled for the "base year" for lubricating oils described in the Memorandum for European Markets; i. e., the 12 months ending June 30, 1929, and for each calendar year from 1929 through 1936. For efforts to develop marketing arrangements for lubricating oils on the international level, see above, pp. 230 and 242.

[54] International Petroleum Trade, op. cit. March 28, 1938, pp. 58–60.

[55] Estimated total consumption of petroleum products in Sweden, including bunkers but excluding military consumption, was 7,480.000 barrels in 1936, according to the Oil Weekly, January 31, 1938, p. 22. If the above figure is converted from metric tons to barrels (using the standard average converting factors given in International Petroleum Trade, February 25, 1938, p. 28), the following results appear: Of this total consumption about 83 percent was in "controlled products," about 5 percent in lubricating oils, about 0.6 percent in specialty items, and less than 12 percent in bunkers.

All important products, except lubricating oils, were subject to the cartel arrangements described earlier in this chapter. Lubricating oils, accounting for a small part of the total market, were not subject to these cartel arrangements but may have been subject to other controls. No information is available for specialty items, which formed a negligible fraction of the total market. Bunker oils were not subject to these arrangements governing the internal market, but these oils, because of the nature of their market, were peculiarly the province of the major international oil companies.

During the decade of the 1930's, Sweden ranked about eighteenth in size among the principal petroleum-consuming nations of the world. Sweden's total annual consumption [56] of petroleum products during this period was less than 0.5 percent of total world consumption, and from 0.7 to 0.8 percent of United States consumption. Swedish consumption was roughly equivalent in volume to that of Holland, about one-tenth that of the United Kingdom, about one-sixth that of France, and about one-fifth that of Canada or Germany. While Swedish consumption in 1947 and 1948 was 2 to 2½ times as great as that of a decade earlier, its relative importance had only increased slightly.[57]

During the 1930's, Sweden was wholly dependent upon foreign sources for its petroleum. During this period, nearly 95 percent of Sweden's petroleum imports were refined products, particularly motor fuel and gas and fuel oils,[58] the other 5 percent of imports being crude oil to be refined by the Nynas Petroleum Co. While a small domestic shale-oil industry was developed during World War II, its maximum contribution in 1945 was but a fraction of 1 percent of Swedish supply.[59] The expansion in 1938–40 of Nynas' Nynasham refinery increased domestic refining with the result that about 12.5 percent of the Swedish market was supplied by local refineries in 1947.[60] Practically all of the crude oil imported in 1947 was from countries whose petroleum economies were controlled by the large international oil companies.[61]

Cartel operations: An analysis of the cartel arrangements in Sweden reveals that the matters that were mutually agreed upon fall within two categories. In one, are the stipulations, joined in by all six important participants in the Swedish oil market, which fixed prices, regulated selling conditions, and classified customers. Standard (New Jersey), Shell, BP, and Texas cooperated in these matters from the spring of 1931, and were soon joined, more or less formally, by Nynas and Nafta. These arrangements were restated in broad and elaborate documents in 1936.

The international "as is" principles contemplated a much more tightly knit structure, however, including the fixing of quotas, the

[56] Including bunker deliveries, but excluding military consumption.

[57] Consumption in 1947 was 23,491,000 barrels; i. e., about 64,370 barrels daily (International Petroleum Trade, January 31, 1950, p. 22). Compared with the data given in table VI, p. 19, this is about 0.7 percent of world demand, excluding the U. S. S. R., however, and about 1.1 percent of United States demand in that year.

[58] International Petroleum Trade, op cit., March 28, 1938, pp. 58–59.

[59] (Ibid., February 28, 1949.) Peak production of refined products from shale oil was 583,000 barrels in 1945, but production in subsequent years fell off sharply.

[60] In 1947 Swedish consumption of petroleum products was about 23.5 million barrels; total imports (excluding crude oil) was 19.7 million barrels; production of refined products from shale oil was 0.4 million barrels; and from crude oil, about 3 million barrels (ibid., October 31, 1949, pp. 204, 209).

[61] In 1947 imports of crude oil, totaling about 3,334,000 barrels, were divided by country of origin as follows: Venezuela, 66 percent; Colombia, 9 percent; Saudi Arabia, 22.5 percent; and Mexico, 2.5 percent.

division of the market, so that the relative position of the parties would be undisturbed, and adjustment of over- and under-trading. It is not clear from the report of the Oil Investigating Committee how closely the terms of some of the various Swedish agreements approximated these "as is" principles; e. g., the often-repeated stipulation that the parties would "respect" one another's customers. Nevertheless, the "as is" group—Standard (New Jersey), Shell, and BP—applied these principles from the start for all controlled products,[62] and were joined by some of the other concerns with respect to asphalt in 1932 and 1935, and with respect to benzine, water-white kerosene, motor kerosene, and possibly other products in 1937.

The principal administrative device for administering the cartel arrangements was the weekly meeting of the principal officers of the cartel members. In these meetings, negotiations were regularly conducted upon questions of interpretation of the various agreements and understandings and for the settlement of issues in current problems arising in the course of business operations. In short, these meetings were the principal means of continuous and full cooperation among the cartel members, and, in fact, were compared by the oil investigating committee to a "permanently functioning board of cooperation." The meetings were usually held in Shell's offices, and Shell acted as the executive organ for the group. Minutes were kept of all meetings recording the discussions and decisions that were made. The committee reports that, in 1937, 55 meetings were held at which 897 subjects were discussed; in 1938, 49 meetings were held at which 656 subjects were discussed; and, in 1939, 51 meetings were held at which 776 subjects were discussed.[63]

The memorandum for European markets and the Draft Memorandum of Principles both provided that the local representatives of the "as is" companies would each submit at their regular group meetings duly audited and certified lists of deliveries made by the marketing subsidiaries, together with estmates of the sales of outsiders.[64] That this was done during the period 1928–36, is demonstrated by the data from which charts 21 and 22 were prepared.[65] Similar provisions to these were incorporated in the Swedish "as is" agreement of October 15, 1937, and the companies informed the oil investigating committee that they did, in fact, exchange such statistics through a common agency set up for that purpose. This practice was resumed after the end of World War II.

The Swedish cartel arrangements provided that the cartel members

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[62] Although Texas participated in all agreements up to 1939, it is not made clear at any place that it participated in the quotas and other distinctive "as is" arrangements prior to 1937.

[63] These figures refer to "principal" meetings only, i. e., meetings of the managing directors of the companies. The memorandum for European markets prescribed such meetings fortnightly, and the Draft Memorandum of Principles, monthly. In addition to the "principal" meetings, there were an undetermined number of meetings of district representatives of the companies, and of meetings regarding special products, e. g., black oils.

The committee contended that the regularity and frequency of these meetings and the great number of subjects discussed, all dealing with cartel and related matters, established the fact of close "cooperation" or "association" among the companies. The committee concluded that it was "not possible to attach any importance" to the contrary position of the companies.

[64] The exact language in the Draft Memorandum of Principles (art. VI) was that there should be presented "a complete list of the participants' invoiced deliveries for each product." It is not clear from this language exactly what information was to be submitted, but the use of the word "invoiced" would suggest that something more than mere totals of quantities sold were meant, that is, that the information desired may have included names of customers, prices, and selling conditions.

[65] Charts 21 and 22 are at pp. 300 and 302. (See also tables 15 and 16, pp. 301–303.)

were to agree upon and apply uniform prices and sales conditions in all cases except where uniform rebates or other deviations from the "official prices and terms" were allowed for special categories of customers. The oil investigating committee reports that there were comparatively few negotiations over the basic price system in the period after the agreements of 1936 and 1937 were concluded, since price levels for petroleum products were generally stable during this period.[66] However, negotiations on prices and terms for special customers occurred repeatedly during the "principal" meetings of the companies.

Nevertheless the minutes of "principal" meetings and other documents available to the committee made it apparent that the general changes in prices that did occur in the later 1930's were the result of decisions made by the oil companies. One example of such a decision is that made at a meeting on July 7, 1937, which increased prices of illuminating kerosene, power kerosene, and automative gas oil. The minutes of this meeting record not only this decision to raise prices by fixed amounts in the different localities, but also a decision that each company should send its sales organizations a prescribed telegram at 4 p. m. of the day of the meeting announcing the new prices which were to go into effect the following day.[67] A second case of a decision to raise prices is that made in meetings on October 15 and 19, 1937, when it was decided to increase benzine prices. Assurances were received from the IC [68] that it would try to induce its member associations to adhere to the new prices, and from Svenska Foil, an independent marketer, that it would apply a corresponding increase in price. A third example of decisions by the companies fixing the general level of prices and selling conditions, in the opinion of the committee, was the draft agreement for January 1, 1947.

There were two often repeated provisions in the international and the Swedish documents relating to the protection and surrender of customers. One was the recurring stipulation that—

> without wanting to encroach in any way on the customer's choice of supplier, they (the companies) *would respect each other's customers*.[69]

Similarly, the closely related provision appears frequently in the documents that, notwithstanding the general rule protecting the established division of customers, adjustments of over- and under-trading were to be made whenever possible by transferring customers from one participant to the other. As in the general agreement, "large contracts" were viewed as a specially suitable kind of business for these adjustments.

The oil investigating committee found that discussions of the protection or surrender of customers appeared usually in the minutes in connection with the negotiations over special customers' prices and terms and in negotiations over purchases by state and municipal institutions.

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[66] The committee ventured no opinion as to the causes of this price stability during a period when the companies insisted that there was "violent war" in the market.

[67] Part of this prescribed telegram read as follows: "All distribution from stock today of products mentioned must cease at 5 p. m. No deliveries may be made at old price after time mentioned. Shortages of empties not accepted as reason for after-deliveries. Branch and depot offices and agents shall confirm direct to head office that no products have left the stocks at old price after time fixed. The company orders that the above instructions be strictly followed. Deviations involve serious consequences to those concerned."

[68] An association of automobile owners' purchasing associations.

[69] Italics added.

The committee reports a number of typical cases showing the tone and direction of the negotiations over special customers' terms. In the minutes of a meeting on January 31, 1936, for example, it was decided that prices charged the Stockholm tramways for benzine and bentyl were far too low and should be raised by the tramway supplier, Gulf. In order to protect Gulf against the loss of this large customer and thus make possible the increase in price, it was agreed that the other oil companies, if invited to make offers, would quote the tramways a higher price than that which Gulf was to charge under this decision. Similarly, it was agreed on January 7, 1937, that Shell, which supplied the tramways with gas oil, should, upon the expiration of the current contract, quote a price 20 percent higher than before. The other conditions of sale were also fixed by agreement of the parties.

> Standard, Texaco, and BP declared their willingness to protect this price quoted by Shell in such a way that, in the event of the tramways applying to them with an inquiry, *they would quote a higher price, varying for the parties concerned.*[69]

Gulf[70] "promised not to disturb the customer in question" and agreed to quote a higher price, also, but pointed out that it had previously promised the tramways that it would meet the prices for gas oil that were offered by "any of the other oil enterprises operating in this country." If pressed by the tramways, Gulf promised to "get into contact with Mr. Gustafson, Shell, and settle the question of price in consultation with him.[71]

A number of provisions in the various documents regulate business with state and municipal institutions. The Draft Memorandum of Principles, for example, declared that quotations for government business should only be made after the companies had fully consulted in advance, but that no party should be restricted from quoting for such business if necessary for political or other important considerations. In a supplement to the Swedish "price system" agreement of January 31, 1936, it was agreed that no other rebates than those usually applied to the general public would be granted for purchases by state institutions which bought privately, such as regiments, hospitals, and the pilotage service. In the Swedish "as is" agreement of October 15, 1937, it was decided that new offers for all transactions with state and municipal institutions should contain uniform prices and selling conditions. It was decided, further, at a meeting on January 12, 1937, that offers to such institutions should not be submitted by retailers but by the "companies' own organizations," i. e., the companies should handle such business directly from their head sales offices to insure that the terms of the agreements were fully applied.

Negotiations were regularly had with regard to tenders for business to state institutions, municipalities, and semi-state-managed institutions, and with regard to the possible transfer of these major consumers in adjustment of over-and-under trading.[72] The interest of

[70] Actually Gulf's affiliate Alfred Olsen & Co.

[71] All quoted statements are from the minutes of the meeting. The minutes of the meetings indicate that these questions were settled only after long negotiations during which the reluctance of some parties to give up an opportunity to acquire these customers was overcome. Similar decisions were made with regard to pooling and dividing up the business in other markets, the manipulation of prices, fictitious quotations of prices, etc., being agreed upon as devices to steer the customers to their assigned suppliers. Thus, Texas was to have the deliveries to the Gothenburg Association of Taxi-Owners, while other business in the Gothenburg area was to be steered to the other oil companies.

[72] Statement of the managing director of the Swedish Shell Co. In the translated copy of the Report of the Oil Investigating Committee, the numerous examples of the allocation of municipal customers were omitted.

the parent companies in this matter is reflected in a letter written by one of the subsidiary companies to its parent company office in London reciting difficulties that had arisen in the allocation of some state business. The letter, as summarized by the Oil Investigating Committee,[73] reported that the subsidiary company, which was an undertrader, was anxious to adjust its trade figures, in accordance with the usual practice, by the reallocation in its favor of the benzine business of the state railways. Another company, an overtrader, was reluctant to do this—this company was always "anxious" to get its full "share of each business that cropped up"—chiefly because it feared that another large consumer would not renew its contract at the expiration date. Since the recalcitrant party would not yield to persuasion, the parent company was asked to see if it could do anything in this matter, presumably in the principal offices of the oil companies in London.

The Oil Investigating Committee reported that the Swedish consumers' associations had generally attempted to safeguard the interests of their members but "had not been able to influence conditions on the market to any extent worth mentioning." [74] Nevertheless, they had an irritating effect upon the cooperative efforts of the oil companies, particularly with regard to prices. The companies seem to have been able to keep matters under control, however, chiefly through their control over supplies.[75]

The relations of the oil companies with the IC organization,[76] the most important cooperative in the petroleum market, are instructive. In a draft memorandum written on May 5, 1937, Standard (New Jersey), Shell, Texas, and BP reached a tentative agreement with the IC and its member associations.[77] IC's practice had been to import petroleum products,[78] but, since its supplies from importation were insufficient to meet its needs, it had been required to purchase supplies from the oil companies on what IC generally regarded as unsatisfactory terms. It was contemplated in the memorandum that IC would buy its total requirements from the four companies,[79] except for supplies already contracted for from Nynas and other small importers; that IC would sell only to its member organizations and would not increase the number of its member organizations; and that it would furnish trade statistics to the companies and apply the same prices and selling conditions as the companies. On the companies' part, they would not try to sell to IC's member organizations except to those which were already customers.

Subsequent events showed that IC did, in fact, generally comply with the stipulations regarding prices and selling conditions. The minutes of a group meeting on June 9, 1937, show that IC and the oil company representatives "unreservedly" agreed to join in the above

[73] The committee was not allowed to quote directly from this letter dated May 8, 1938. See above, p. 386, footnote 41.

[74] Ch. II of the report of the committee.

[75] The remarks made below, p. 297, concerning the difference between the "supply" position and the marketing or "distribution" position of the companies are particularly relevant here.

[76] The IC was an association of automobile owners' purchasing organizations including owners of commercial vehicles.

[77] This agreement was neither signed nor dated, and as much as a month later the companies thought that everything was definitely settled. The IC told the investigating committee that they had not found it possible to accept the terms of this agreement.

[78] The IC purchased from Nafta until that company began its cooperation with oil companies in 1932. Thereafter, the IC attempted to import its requirements but was not successful in finding adequate supplies.

[79] Prices were to be fixed on United States Gulf quotations plus freight and other charges.

agreement, which was to become operative at a time to be agreed upon. IC's representatives agreed to attempt to eliminate price cutting on the part of its member organizations, and questions regarding the protection or transfer of certain customers of IC and the companies were settled. IC also promised to purchase equivalent quantities of benzene from the companies should some customers refuse to be transferred. On July 1, 1937, IC agreed to prevent a member organization from expanding into a territory where Shell had eliminated rebates to a consumer's cooperative.[80] Finally, IC agreed to cause its member organizations to apply the general increase in prices voted by the oil companies effective on November 1, 1937.[81]

The oil companies similarly brought pressures to bear upon other consumers organizations, such as associations of property holders, the National Association of Swedish Farmers, and the several fishery associations. The tactics used included lessening the amount of or eliminating discounts, rebates, bonuses, commissions, and the like, refusal to make additional deliveries to associations which increased their membership or to enter into contracts with new associations, and so on. In short, it was agreed that every measure should be taken to avoid "the risk of such organizations growing too strong, whereby difficulties may be caused to the companies." To this end it was agreed, on June 10, 1938, that—

> no negotiation, either directly or indirectly, must take place with buying organizations, associations of property holders, or similar associations without the matter having been discussed in advance with the other participants.

Aside from the six principal oil companies and the various consumer cooperatives, the only independent competitors in Sweden were a few small importer-marketers.[82] The Investigating Committee remarked that the oil companies brought concerted pressure to bear on these enterprises to insure their adherence to the established price policies. Minutes dated June 11, 1937, for example, record a case where a retail outlet of one of these independent competitors cut prices. The managing director of BP acted for the group in undertaking—

> to impress effectively on the supplier (i. e., the independent enterprise) * * * that the benzene prices fixed for the place in question shall be observed.

The principal goals of the Swedish agreements, according to the oil companies, were to eliminate market developments which, from their point of view, were highly unfavorable. The agreements were liberally peppered with statements of the desirability of clearing up the existing "price chaos" or "unsound rebate conditions," or of achieving "a better order in respect of selling price." The purpose of the Swedish "as is" agreement of October 15, 1937, was stated as follows:

> to arrive at and maintain a *stable and normal price level* in the Swedish market, and, *through better cooperation* make it possible for the companies to run their business as economically as possible.[83] * * *

The oil companies also insisted that the various agreements and

[80] Bjasta, the place where this cooperative was located, was referred to in the minutes of the meeting of April 7, 1937, as an "infected place," and it was proposed that the companies eliminate their selling points there.

[81] IC also agreed to cause its member associations to eliminate "exceptional prices where such had been granted" as well as apply the price increase.

[82] The number of these concerns apparently varied from time to time. In 1939, it is reported, there were only two of these independents in Sweden. International Petroleum Trade, September 30, 1940, p. 358.

[83] Italics added.

other documents represented a cooperative spirit among the oil companies that was more apparent than real, since it was contended that the company representatives had not adhered to the decisions they had themselves made.

The Oil Investigating Committee concluded that "*it is indisputable that the development of price on this market has not been the result of free competition between the various enterprises.*" [83] This remark of the committee was, in effect, a summary of their reply to the two arguments advanced by the companies. On the one hand, the committee stated that, since they were able to determine costs, prices, and profits of the oil trade only for the domestic trade in Sweden, as they did not have access to the accounts of the parent corporations covering the operations of exploration, production, refining, and transportation, they were unable to determine as a matter of fact whether or not the prices in Sweden had been reasonable and the oil trade in Sweden remunerative.[84] In the opinion of one expert, a former official of Texas Co. in Sweden, "the agreements were most dangerous to the State, since when making purchases, the State accepted the lowest price offered, even when this happened to be higher than that paid by certain other consumers." The committee also found a letter from a subsidiary concern to its parent, written in April 1939, stating that benzene prices were unduly high in the current market, but that they would not be reduced because two of the companies wanted to recover during the year their investments in new plant facilities. The committee, in short, was skeptical of the argument that cooperation was begun and maintained because of ruinous marketing conditions, and replied simply that there was no "free competition" in the market. The committee's view seems to have been, rather, that cooperation in Sweden was largely due to the international "as is" agreements.

As to the second argument, the committee agreed that there was undoubtedly a gap between the letter of the agreements and their application, since a complete application would not have been possible in any event. The committee's view was that it was not necessary to explore the question of the extent to which the agreements were applied, since those who made the agreements presumably intended to abide by them.[85] The managing director of Shell told the committee that "the documents have been prototypes of how the companies wanted things to be," i. e., the companies wanted a strict regulation of the market in accordance with the terms of the agreements. On another occasion he remarked that, assuming that the oil trade programs were prepared on a basis of 100-percent cooperation, the companies had had to be content if 50- or 60-percent cooperation were actually attained.

[83] Italics added.
[84] Chapters IX, X, and XI of the Swedish Report. See also footnote 21, on p. 281.
[85] See below, p. 308, footnote 28.

Quota arrangements.—The quota arrangements outlined by the international "as is" agreements were adopted and applied in the Swedish market by the "as is" group of companies and were included in modified form in the five-party Swedish "as is" agreement on October 15, 1937.

The Memorandum for European Markets established, and the Draft Memorandum of Principles continued, a system of "distribution" or "total consumption" quotas.[86] These were designed to protect the division of markets among the participants that had actually existed during the base year. Each participant was recognized as being "entitled" to his established quota or proportion of the total market for each petroleum product, and the parties mutually agreed to "respect" these quotas. Over- and under-trading among the parties was to be "adjusted" by a system of fines and compensation. Gains and losses in the market attributable to "outsiders" were to insure to the sole benefit or injury of the participant making the gain or suffering the loss.

The "distribution quotas" should be carefully distinguished from the total "supply position" of the "as is" participants in each country. The international agreements set forth detailed principles designed to safeguard the relative "supply position" of each participant in each national market,[87] that is, the position of the international oil companies as suppliers not only of their own marketing subsidiaries and outlets in each country but also as suppliers of "outside" marketers. The "distribution quotas," on the other hand, were managed at the level of the local markets and controlled the activities of the domestic marketing subsidiaries of the "as is" group and their marketing outlets. The distribution quotas that were fixed from time to time in Sweden are reproduced, for the more important products, in table 14.[88]

The basic quotas, as shown in the first column of table 14, represent the percentages of each product market actually held by each "as is" participant during the "base year" or "qualifying period," 1928. Under the agreement, they were the share of the product markets to which each of the parties was entitled. Except for asphalt, these quotas remained in effect until January 1, 1936, but in fact part of the "basic quotas" failed to represent actual marketing conditions after 1930, as will be explained below.

[86] See discussion above, p. 230 ff.
[87] See discussion above, p. 256.
[88] Distribution quotas for white spirit, gas oil, and automotive gas oil are omitted. The quota for automotive gas oil, effective January 1, 1936, was identical to that for benzine in accordance with addendum VI of the Draft Memorandum of Principles. See p. 261, footnote 42.

Data in table 14 and discussion in the text relating to quotas prior to 1937 are based on Standard (N. S.) documents, Deliveries Into Consumption—Europe. Data and discussion relating to the quotas for October 1, 1937, are based on chapter XII of the Swedish Report.

TABLE 14.—*Distribution quotas under Swedish "as is" arrangements*

[Expressed in percentages]

BENEZINE QUOTAS

Company	Basic quota, 1928	Effective— Jan. 1, 1936	Effective— Oct. 1, 1937
Standard (New Jersey)	37.03	28.06	28.06
Shell	42.94	32.53	32.53
AIOC (BP)	1.94	8.43	8.43
Texas			12.92
Gulf			12.09
Total quotas	81.91	69.02	94.03
Outsiders	18.09	30.98	5.97
Total market	100.00	100.00	100.00

WATER WHITE (ILLUMINATING) KEROSENE QUOTAS

Company	Basic quota, 1928	Effective— Jan. 1, 1936	Effective— Oct. 1, 1937
Standard (New Jersey)	61.14	51.03	51.03
Shell	30.62	25.57	25.57
AIOC (BP)	.70	4.80	4.80
Texas			9.36
Gulf			7.29
Total quotas	92.46	81.40	98.05
Outsiders	7.54	18.60	1.95
Total market	100.00	100.00	100.00

MOTOR KEROSENE QUOTAS

Company	Basic quota, 1928	Effective— Jan. 1, 1936	Effective— Oct. 1, 1937
Standard (New Jersey)	36.41	28.21	28.21
Shell	39.53	30.61	30.61
AIOC (BP)	.44	7.50	7.50
Texas			11.32
Gulf			15.28
Total quotas	76.38	66.32	92.92
Outsiders	23.62	33.68	7.08
Total market	100.00	100.00	100.00

DIESEL OIL QUOTAS

Company	Basic quota, 1928	Effective— Jan. 1, 1936	Effective— Oct. 1, 1937
Standard (New Jersey)	47.42	38.14	
Shell	52.58	42.29	
AIOC (BP)		6.52	
Total quotas	100.00	86.95	
Outsiders		13.05	
Total market	100.00	100.00	

ASPHALT QUOTAS

Company	Basic quota, 1928	Effective— Jan. 1, 1932	Effective— Aug. 1, 1932	Effective— Jan. 1, 1935
Standard	56.62	57.51	56.32	32.74
Shell	33.65	32.76	32.08	18.66
Texas			2.96	2.96
Nynas				37.00
Total quotas	90.27	90.27	91.36	91.36
Outsiders	9.73	9.73	8.64	8.64
Total market	100.00	100.00	100.00	100.00

The great changes in the Swedish market between 1928 and 1936 were given recognition in revised distribution quotas, effective January 1, 1936. Among the most important of these changes was the position acquired in each product market by "outsiders"—Texas, Nynas, Nafta, and others—and guaranteed already in large measure by the agreements of the oil companies to "respect" one another's customers. These de facto positions were recorded, in effect, along with "special quotas" for BP, when Shell and Standard substantially reduced their quotas for each product, except asphalt, for which quota adjustments had already been made. In other words, to accommodate the "outsiders," Standard and Shell agreed that they were "entitled" to substantially smaller portions of the market. As an examination of table 14 will show, the quotas of Standard and Shell were simply reduced in ratio to the size of their "basic quotas" rather than according to any formula in the various international or local agreements.

Insight into the process of revision of quotas is afforded in the case of the greatly increased quotas granted to Anglo-Iranian (AIOC), or BP. The increase in AIOC's benzine quota was explained by a Standard (New Jersey) official in these words:

> Compensation is given by AIOC to SOC (New Jersey) and Shell for the difference between this special "local quota" and AIOC's "as is" quota of 1.64 percent; *such compensation takes the form of a reduction of SOC of New Jersey's and Shell's obligation to lift gasoline from AIOC under the benzine agreement.*[89]

In short, the local quotas in the case of benzene, and probably in the case of the increases granted AIOC in all other product markets except asphalt, were fixed on the basis of other internal arrangements of the "as is" group made on the international level.

Further insight into the quota mechanism is provided by the quota schedules for asphalt, which show the earliest known cases in Sweden of the admission of "outsiders" to the distinctive "as is" arrangements. The first revision of the basic quotas, effective January 1, 1932, records the acquisition of an outsider by Standard (New Jersey).[90] This revision reflects the readjusted relative positions of Standard and Shell, however, rather than the facts of greatly changed positions in the market.[91] Effective August 1, 1932, the distribution quotas were again revised to show the entry of Texas into "as is" and, effective January 1, 1935, a further revision was made upon Nynas' adherence to "as is" principles. The quotas assigned to Texas and Nynas both reflect the share of the asphalt market each held in the calendar year prior to their admission to the quota arrangements,[92] and the four parties now

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[89] Italic added. Memorandum on European and North African Benzene Distribution Quotas, dated January 10, 1936, and initialed J. H. R. No explanation is given of the term "Benzine Agreement."

[90] Standard (New Jersey) purchased all foreign interests of Standard Oil Co. of Indiana in 1932. The purchase included a German firm, Ebano, which marketed asphalt and other petroleum products in a number of European countries.

[91] See table 15 for the actual position of the parties in 1931. Ebano's share of the asphalt market in 1931 was 2.89 percent.

[92] The revisions in the quota arrangements to account for Texas' quota of 2.96 percent, the actual share it had of the 1931 market, were made as follows: Texas' share of the market in 1928, the "qualifying period," was 1.09 percent; the share of the total market belonging to "outsiders" was accordingly reduced by this quantity. The balance of 1.87 percent was taken from the quotas of Standard and Shell in proportion to the relative size eof their quotas, i. e., Standard's quota was reduced by 1.19 percent and Shell's quota by 0.68 percent.

Nynas, on the other hand, was not in the asphalt or, for that matter, any other market in 1928. Its actual share of the market in 1934 was 37.05 percent. Its quota of 37 percent was made by reducing Standard's and Shell's quotas in proportion to their relative size; i. e., Standard's quota was reduced by 23.58 percent and Shell's by 13.42 percent.

"recognized" their respective "right" to the shares of the market signified by their quotas.

The Oil Investigating Committee reports that distribution quota arrangements were entered into by the five parties to the agreement of October 15, 1937. These quotas were effective as of October 1, 1937, and are shown in table 14 for benzene, water white kerosene, and motor kerosene.[93] The quotas to which the members of the "as is" group—Standard (New Jersey), Shell, and BP—were "entitled" remained unchanged from the revision effective on January 1, 1936. The quotas to which Texas became "entitled" were generally somewhat higher than actual performance in earlier years, while those for Gulf were somewhat lower than the actual performance of Nafta, the predecessor organization which Gulf had purchased in the spring of 1937.[94] As these pages indicate, therefore, the effect of the revisions of 1936 and 1937 was substantially to substitute 1935 for 1928 as a "base year" or "qualifying period."

The 1937 agreement also provided that the companies were "entitled" to change their distribution quotas for the different products provided that their "fixed total distribution quotas" were not exceeded; i. e., the total quantity of products sold did not exceed the total quantity allowable under the distribution quotas for the different products.[95]

The Oil Investigating Committee was not able to supply full information on the administration of provisions regulating adjustments for over and undertrading under the quota arrangements. It states that there were such adjustments in 1935 and 1936, and "probably also for 1934." It does not state how these adjustments were arrived at nor the amounts of the fines paid and compensation received by the parties.

The agreement of 1937 included provisions for the adjustment of over and undertrading among the five parties, which generally accorded with those principles set forth in the Draft Memorandum of Principles.[96] The oil companies stated that they could not trace any adjustment made in the period after January 1, 1937, nor could the committee establish whether such adjustments had been made through the parent companies. The committee had fragmentary evidence that such adjustments had been made,[97] and that fines were paid in connection with the adjustments.

[93] The Oil Committee reports quotas only for these products, but does not indicate whether or not five-party quotas were agreed upon for Diesel oil, gas oil, automotive gas oil, or white spirit. The asphalt quotas of 1935 already covered all important Swedish oil companies.

[94] This probably reflects the fact that Texas held substantial shares of these markets in 1928, while Nafta was not in business during this qualifying period. See table 15. Texas' benzine quota is identical to its performance in 1935.

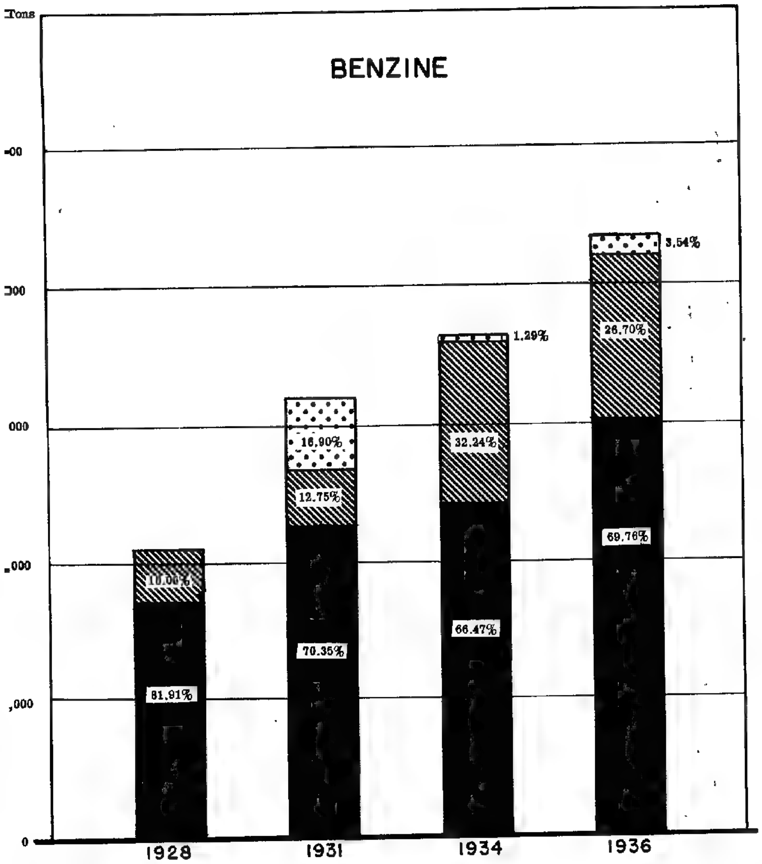
[95] This probably represented concessions to Texas and Gulf arrived at during the negotiations on the agreement.

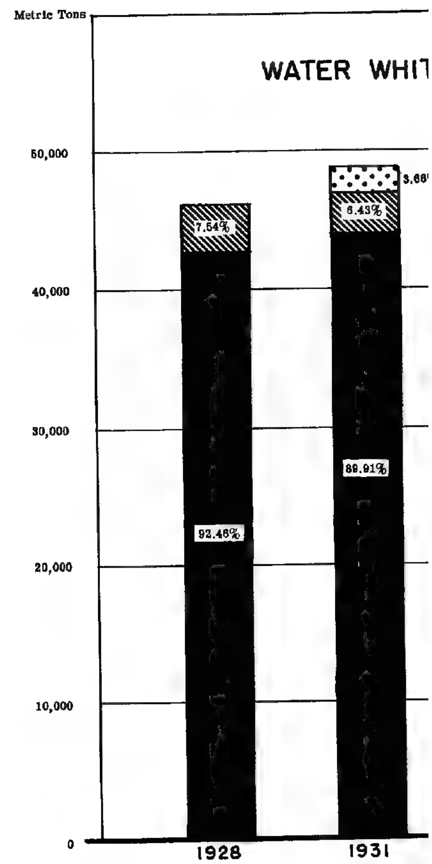
[96] See above, pp. 257–258. According to the committee, the Swedish "as is" agreement provided that these adjustments were to be made at 6-month intervals in accordance with the following procedure: (*a*) Trade losses attributable to outsiders were to be excluded from the distribution quotas, as such losses were "entirely for the account of the losing participant." Trade gains, however, were to be regarded as a joint gain to be shared among the parties in proportion to the distribution quotas. (*b*) The resulting modified quotas were to be the basis upon which adjustments of over and undertrading among the parties were to be calculated. The adjustments were to be made by an assignment of business from the overtrader to the undertrader. If this could not be done or proved to be only a partial adjustment, the undertrader could supply the overtrader "a quantity of the same product amounting to his overtrading therein or the undertrading of the undertrader, whichever was the less." The method of fixing the price in such a sale was not stated in the report. (*c*) The report does not state whether the agreement provided for a system of additional fines and compensation or for revision of the distribution quotas as provided in the Draft Memorandum of Principles.

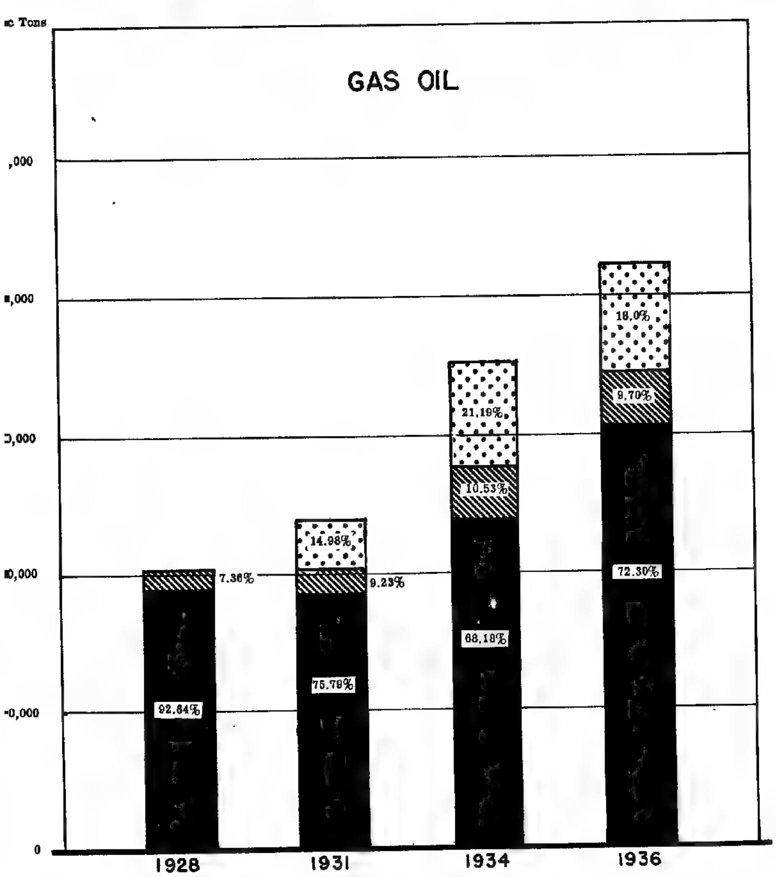
[97] The report originally contained "a schedule of adjustments known to us," but unfortunately this was omitted in the translated document.

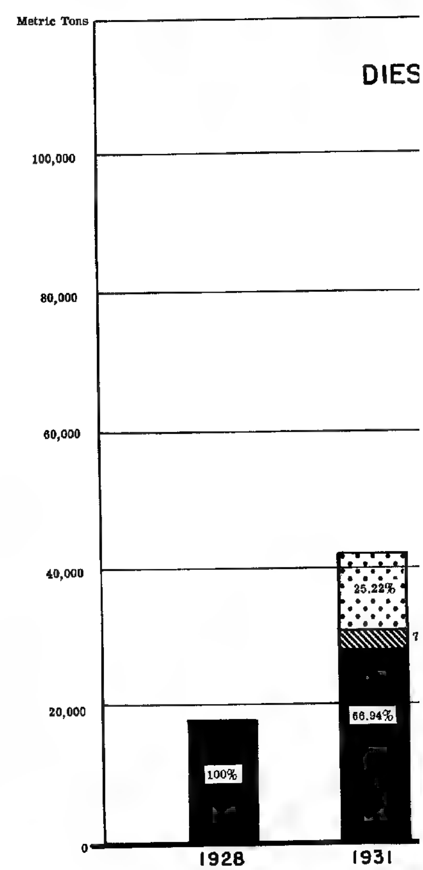
DELIVERIES INTO CONSUMPTION OF PETROLEUM F

"As Is" group



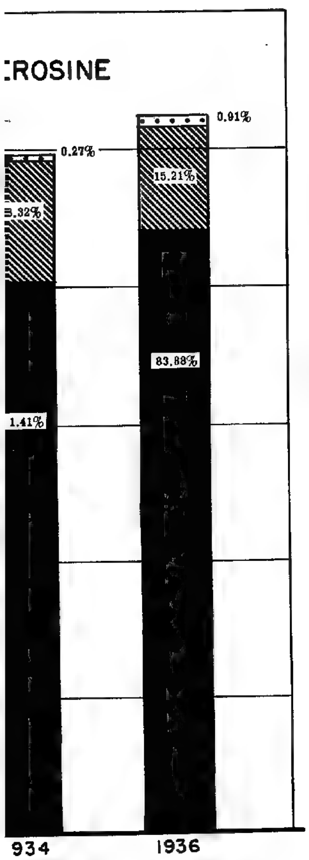


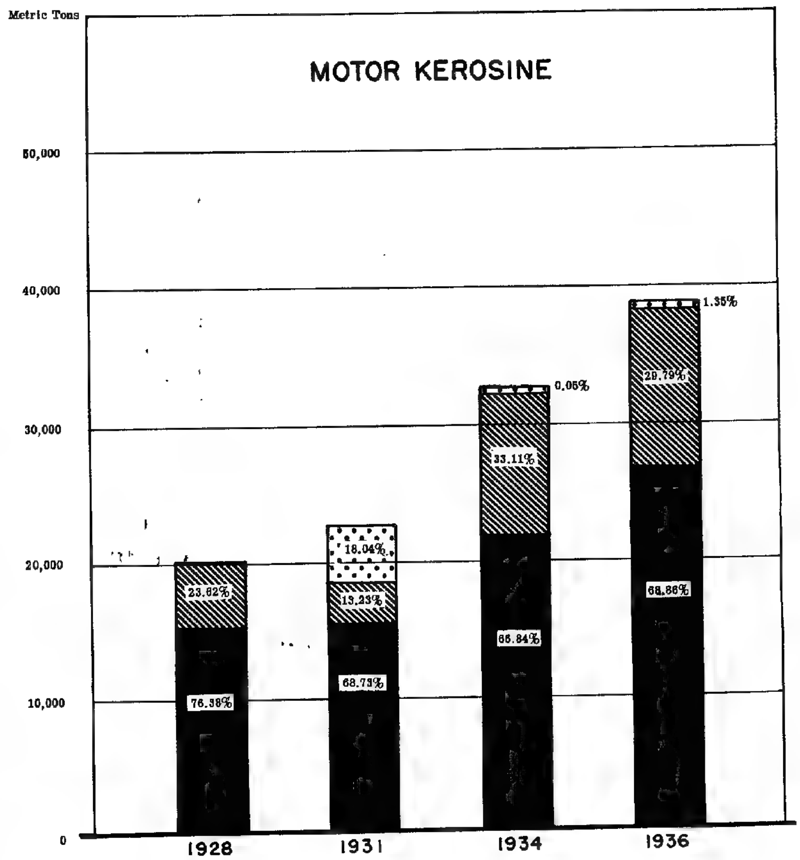


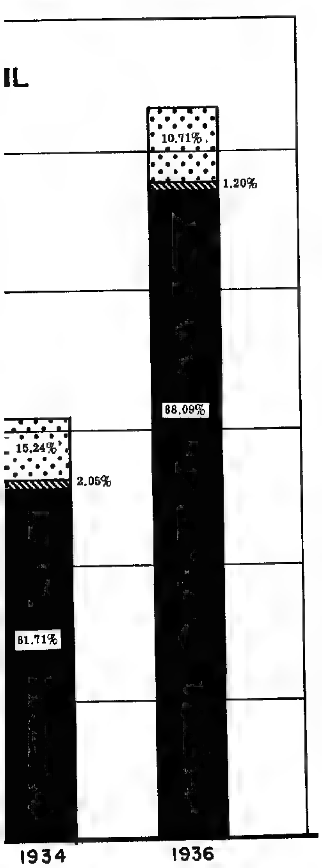


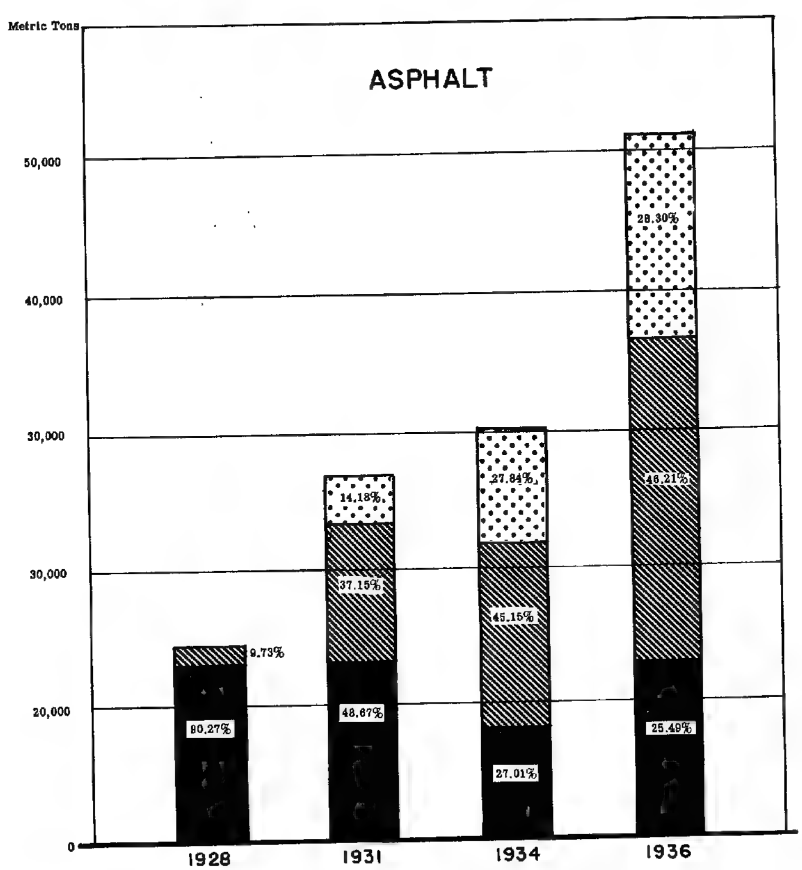
DUCTS IN SWEDEN IN 1928, 1931, 1934 and 1936

artel   Outsiders









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Trading results, 1928–36. The actual "trading results" achieved by the adherents to the cartel arrangements were recorded for the 9-year period, 1928–36, in the documents known as the "Deliveries into Consumption—Europe."[98] Charts 21 and 22 and tables 15 and 16 present data for all products[99] for 1928, the "base year"; 1931, the year in which the Swedish cartel began to operate; 1934; and the last year shown in the documents, 1936. These tables, therefore, cover the most troublesome years in the Swedish petroleum trade, the years of the depression and of the invasion of the market by Nynas, a Swedish refiner-importer-marketer; by Nafta, a Russian Government monopoly; and by Gulf.

In charts 21 and 22, two cartel divisions are shown, one marked "'as is' group," and the other "total cartel." The "as is" group—Standard (New Jersey), Shell, and BP—is set off because of the distinctive arrangements that existed between them as described earlier. Except in the asphalt market,[1] no other companies adhered to these special "as is" stipulations prior to 1937. Somewhat weaker cartel arrangements were adhered to during this preiod by the "as is" group, together with Texas and Nynas. Nafta entered upon a period of "collaboration" in the matter of prices and selling conditions in late 1932 and was a signatory to the "price system" of 1936.[2] The term "total cartel," therefore, signifies the percentages of the product markets held by the five participants in 1931 and 1932, and the six participants after 1932.

TABLE 15.—*Deliveries into consumption of petroleum products in Sweden in selected years*

[In metric tons]

Company	1928	1931	1934	1936
Benzene:				
Standard (New Jersey)	77,786	95,976	98,679	120,646
Shell	90,193	111,087	120,145	146,729
AIOC (BP)	4,087	20,138	24,545	37,253
Total "as is" group	172,066	227,201	243,369	304,628
Texas	28,000	37,240	46,201	55,179
Nynas	--------	3,936	5,848	7,658
Nafta	--------	--------	65,991	53,722
Total cartel	--------	268,377	361,409	421,197
Nafta	--------	53,500	--------	--------
Sundry	10,000	1,100	4,723	15,473
Total market	200,066	322,977	366,132	436,670
Water white kerosene:				
Standard (New Jersey)	28,379	26,704	23,095	23,975
Shell	14,214	16,477	15,412	17,188
AIOC (BP)	323	964	2,036	2,942
Total "as is" group	42,916	44,145	40,543	44,105
Texas	3,000	2,911	3,921	4,683
Nynas	--------	244	165	385
Nafta	--------	--------	5,040	2,930
Total cartel	--------	47,300	49,669	52,103
Nafta	--------	1,500	--------	--------
Sundry	500	300	132	477
Total market	46,416	49,100	49,801	52,580

[98] Standard (New Jersey) does not report any later statistics in their files in this country.

[99] Separate data on white spirit are omitted here, as this product is of minor importance in the Swedish market, accounting for less than 1 percent of total tonnage traded in each year.

[1] See above, p. 299.

[2] See above, pp. 282 and 283.

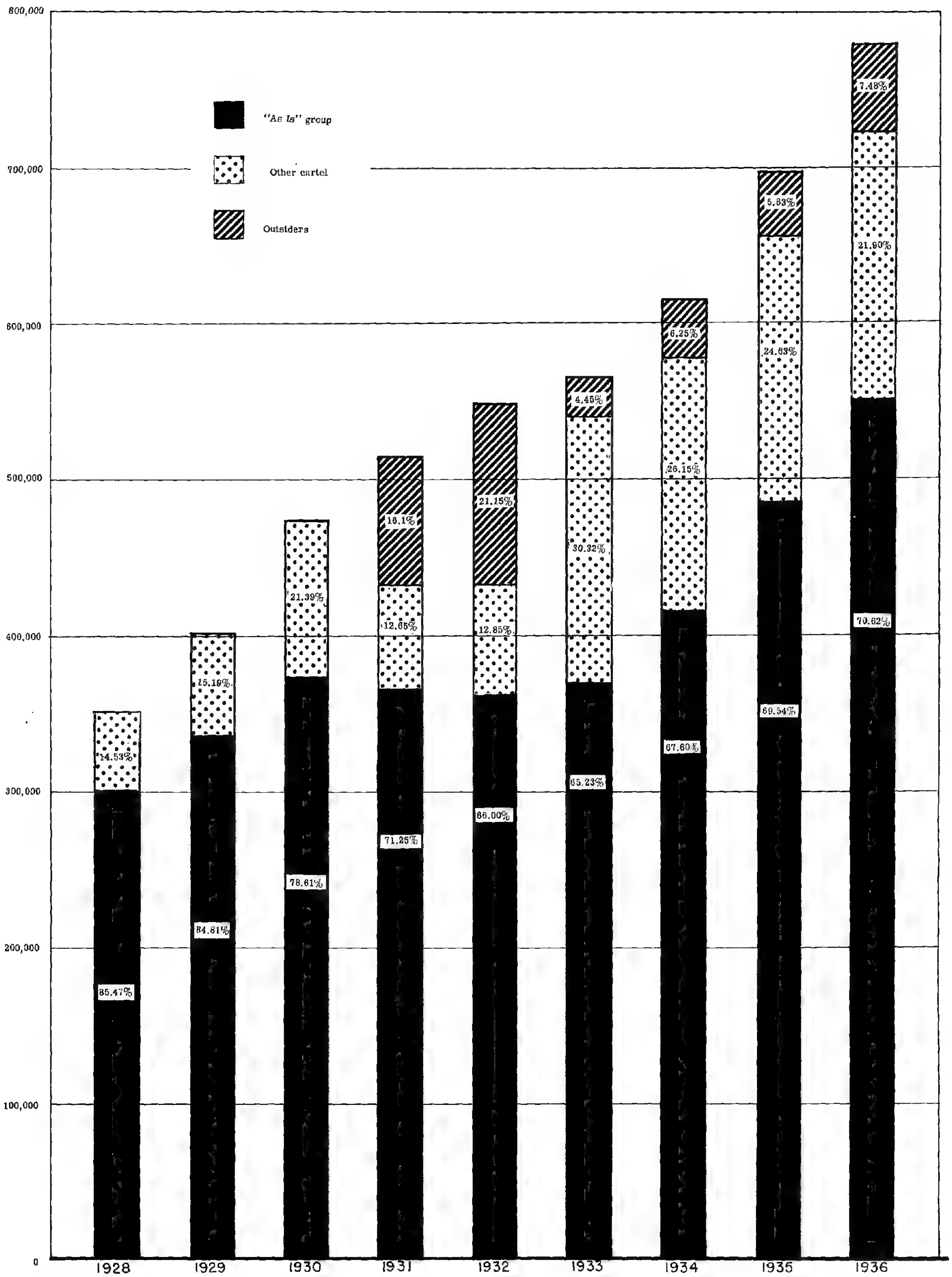
TABLE 15.—*Deliveries into consumption of petroleum products in Sweden in Selected years*—Continued

[In metric tons]

Company	1928	1931	1934	1936
Motor kerosene:				
Standard (New Jersey)	7,321	6,657	8,256	10,064
Shell	7,949	7,698	11,315	13,290
AIOC (BP)	89	1,266	2,299	3,344
Total "as is" group	15,359	15,621	21,870	26,698
Texas	3,250	2,273	3,437	4,287
Nynas		734	597	758
Nafta			6,804	6,504
Total cartel		18,628	32,708	38,247
Nafta		3,500		
Sundry	1,500	600	15	524
Total market	20,109	22,728	32,723	38,771
Gas oil:				
Standard (New Jersey)	15,120	14,090	18,042	24,395
Shell	23,122	22,250	29,249	33,710
AIOC (BP)	40	590	1,311	3,695
Total "as is" group	38,282	36,930	48,602	61,800
Texas	785	2,220	6,078	6,465
Nynas		2,278	1,424	1,817
Total cartel		41,428	56,104	70,082
Nafta		4,300		
A. Olsen & Co. (Gulf)		3,000	14,577	14,825
Sundry	2,258		601	564
Total market	41,325	48,728	71,282	85,471
Diesel oil:				
Standard (New Jersey)	8,473	9,919	17,852	38,677
Shell	9,395	17,475	31,658	50,098
AIOC (BP)		1,007	2,171	5,285
Total "as is" group	17,868	28,401	51,681	94,060
Nynas		3,324	1,279	1,279
Total cartel		31,725	52,960	95,339
Nafta		4,700		
A. Olsen & Co. (Gulf)		6,000	9,525	11,434
Total market	17,868	42,425	62,485	106,773
Asphalt:				
Standard (New Jersey)	8,196	6,766	4,148	6,546
Shell	4,872	6,379	3,961	6,482
Total "as is" group	13,068	13,145	8,109	13,028
Texas	158	799	521	1,816
Nynas		9,233	11,128	18,464
Nafta			1,913	3,332
Total cartel		23,177	21,671	36,640
Sinclair			2,583	12,030
Sundry and other marketers	1,251	3,829	5,777	2,439
Total market	14,477	27,006	30,031	51,109

CHART 22

DELIVERIES INTO CONSUMPTION OF "CONTROLLED PRODUCTS" [1/] IN SWEDEN, 1928–1936



1/ Includes all petroleum products sold for domestic consumption except lubricating oils and specialty products.

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TABLE 16.—*Deliveries into consumption of "controlled products," summary statistics*[1] *for Sweden in selected years*

[In metric tons]

Company	1928	1931	1934	1936
Standard (New Jersey)	145,545	160,490	170,857	226,090
Shell	150,399	182,645	213,400	270,505
AIOC (BP)	4,539	23,965	32,362	52,519
Total "as is" group	300,485	367,100	416,619	549,114
Texas	35,193	45,443	60,158	72,478
Nynas	----------	19,749	20,441	30,371
Nafta	----------	----------	80,548	67,467
Total cartel	----------	432,292	577,766	719,430
Nafta	----------	67,500	----------	----------
A. Olsen & Co. (Gulf)	----------	9,000	24,102	26,259
Sinclair	----------	----------	2,583	12,030
Sundry	15,891	6,462	11,824	19,864
Total market	351,767	515,254	616,275	777,583

[1] Includes all products shown in table 15 and white spirit. "Controlled Products" comprised the bulk of the Swedish domestic oil business.

Gulf, through its affiliate, Alfred Olsen & Co.,[3] held a share of the gas oil and Diesel oil markets during most of this period, but the Oil Investigating Committee does not report that it participated in any agreements prior to 1936.[4] In 1937, Gulf purchased the business of Nafta which, together with its gas and Diesel-oil business, it consolidated into the Swedish Gulf Oil Co.[5] In this capacity, it entered into the agreement of October 15, 1937.

Aside from the "other cartel" members who are included in charts 21 and 22 as "outsiders" prior to their entry into the cartel, the only outsiders in the Swedish oil market were the Swedish cooperative societies and a few small importer-marketer firms. These were referred to collectively in the "deliveries into consumption" as "sundry marketers" and typically held negligible fractions of most markets, except asphalt.[6] The Swedish cooperative societies occasionally imported petroleum products but usually bought their supplies from the oil companies, performing various wholesale and retail functions for their members. Although the cooperatives, as has been shown,[7] posed a constant threat to the cartel arrangements, the oil companies were generally successful in controlling the situation.

It appears from a cursory inspection of charts 21 and 22 that the "as is" group suffered considerable losses from its position in 1928. Actually nearly all of these percentage losses occurred during the period 1929–32, when Nynas, Nafta, and Gulf entered the markets. After the first cartel arrangements were made in 1931–32, the "as is" group slowly improved its position. The fact is that in 1936 the "as

[3] The relations of Gulf and Alfred Olsen & Co. are described below, p. 334.

[4] Gulf had begun collaboration with the cartel group as early as January 1936, and was a participant in the meetings of June and July 1936, see p. 283. Gulf is shown as an "outsider" in charts 21 and 22, but might well be included as a cartel member for 1936. Its share of the various markets for 1936 includes gas oil, 17.34 percent; Diesel oil, 10.71 percent; and, for all "controlled" products, 3.38 percent.

[5] Alfred Olsen & Co. has continued in business as Gulf's marketing subsidiary for lubricating oils and greases in the Scandinavian countries.

[6] Sinclair was the only important outsider in this market. Besides the "sundry" marketers, there were in the different years from 8 to 12 other small foreign and domestic concerns in this market.

[7] See above, p. 294. The independent marketers were of only local significance and were described by the Oil Investigating Committee as holding "negligible" proportions of the trade.

is" group and the Texas Co.[8] had little cause for dissatisfaction with developments after the troublesome years 1930–32. They were getting a smaller slice, percentagewise, out of a much bigger pie. Thus, the actual tonnage traded in the benzene market by the group in 1936 was 77 percent larger than in 1928 although their percentage of the total benzene market had declined 12.2 percentage points.[9] Similar results appear in all markets; in over-all terms, the group's share of the market for all "controlled products" declined nearly 15 percent while their tonnage increased about 82 percent.[9] Moreover, their market in 1936 was assured and stable due to the cartel arrangements. Finally, with the substitution of Gulf for Nafta in 1937, the last doubtful and extraneous element in the markets was removed.

The other cartel participants—Nynas, Nafta, and Nafta's successor, Gulf—also had grounds for satisfaction with the course of events.[10] The positions won by these firms in the 1930–32 period were confirmed and protected by the cartel arrangements that developed after 1931.

The degree of control of the Swedish petroleum markets acquired by the cartel participants is made apparent by an examination of charts 21 and 22. It should be noted that the cartel members and Gulf, which entered the cartel in 1937, accounted for from 95 to 100 percent of all petroleum product tonnage delivered in 1936 for consumption in each product market. As will be seen in chart 22, the cartel members made 92.52 percent of such deliveries, while Gulf made 3.38 percent.[11] All other marketers accounted for only 4.1 percent.[12]

These data represent only one measure of accomplishment in regulating the market. However, taken together with the control achieved over prices and selling terms, as well as over the activities of the small "outsiders," they suggest the attainment of a considerable degree of success.

Attempts to obstruct and mislead the committee.—The international oil companies were hostile to the investigation and report by the Oil Investigating Committee. Their answers to questions were often evasive and nonresponsive, and they made strong objections to the report being made public.

The first step by the committee was to summon the managing directors of the principal oil companies to a meeting on September 25, 1946, at which stenographic records were made. Representatives of the Swedish subsidiaries of Standard (New Jersey), Shell, Anglo-Iranian (BP), Texas, Gulf, and Nynas (a Swedish concern) were present. The chairman of the committee first reviewed the attempts

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[8] These same considerations apply in the case of Texas as for the "as is" group. Texas held about 10 percent of the trade in all controlled products in 1928 and about 8.82 percent in 1931 when it entered the cartel; thereafter its percentage position improved slowly. Its total volume in 1936 was slightly more than double that of 1928.

[9] See tables 15 and 16.

[10] Nynas began operations in 1929 and held between 3 and 4 percent of the trade in controlled products from 1931 to 1936. Nafta, which was founded in 1928, rapidly increased its share of the business, accounting for 13.10 percent in 1931 and 17.97 percent in 1932. Thereafter its share of the Swedish trade declined to 13.07 percent in 1934 and 8.68 percent in 1936. While Nafta's share of the market fell off, its total volume of business in 1936 was about the same as in 1931 and somewhat smaller than in 1934. See table 16. Gulf, through its affiliate, Alfred Olsen & Co., held 1.75 percent of the trade in 1931 and 3.3 to 4 percent in the subsequent years, but its trade was entirely in Diesel and gas oils, in which product markets Gulf was practically the sole outside element.

[11] See above, p. 334.

[12] Chiefly the cooperative associations in the benzine market and various outsiders in the asphalt market.

at cooperation during 1930–33, which had been described in a previous report to the Riksdag. He then asked the following questions:

> 1. Are any of the agreements made in the early thirties still in existence? If not, when did these agreements cease to be effective?
> 2. Did any agreements or any other form of collaboration regarding joint pricing or joint quotations when making offers exist during the later thirties?
> 3. Have such agreements been made or has cooperation regarding pricing or allocation of trade quotas existed after the end of the war.

The representative from each company was separately interrogated. For the most part the answers to these three questions were in the negative, qualified only by assertions that such agreements as had existed had been "oral" or "international" in origin, and that these agreements had never been applied and had never lessened competition.[13] The committee's reaction to these statements was that "the first meeting left the impression that there had been no organized cooperation of any importance worth mentioning between the companies during the period in question."[14]

As a result of further information obtained from Shell and other sources, the representatives of the six oil companies were summoned to a second meeting on November 22, 1946. At this meeting there was considerable disagreement among the company representatives as to whether certain agreements had or had not existed, whether or not they had been signed, and as to their subject matter and provisions. As a result of this second meeting the company representatives promised to search their files, and the committee undertook a full-scale investigation.

In the committee's opinion the representatives of the companies gave "*erroneous and misleading information*" at the two meetings. The committee stated, however, that "the documents requested [from the companies] now seemed to have been placed at our disposal."[15]

Not only did the oil companies attempt to mislead the committee at the very beginning of the investigation, but they also insisted vigorously that the findings of the committee should not be published. Their statements to this effect were published as part of the report,

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[13] The representative of Standard (New Jersey) insisted that there had always been a "violent war" on the market.

[14] It should be noted that the company representatives had been notified at the opening of the meeting that they were liable to criminal penalties if they willfully made false or misleading statements.

[15] Swedish Oil Report, pp. 1 and 41. [Italics added.] At the two meetings the representatives of Shell and BP were, on the whole, more responsible to questioning than those of American concerns. At the second meeting, however, the managing director of BP, who admitted that he had seen a copy of the "as is" agreement, stated that this agreement had nothing to do with local agreements in Sweden.

The responses of the representatives of Standard, Texas, and Gulf may be summarized as follows: The representative of Standard said at the first meeting that the agreements of 1930–33 no longer existed and that they had been instructed by the parent corporation sometime in 1942 not to make any agreements whatsoever. At the second meeting, he is only reported as saying that it was "self-evident" that the parent corporation was kept informed of, but that it had "never interfered" in, local commercial agreements. The representative of Gulf stated at the first meeting that his company had "never" joined in any quota arrangement and that the parent corporation was "most anxious" that the Swedish subsidiary not join in any agreements that might violate the American antitrust laws. At the second meeting, he insisted that he had not signed an agreement on October 15, 1937, though it was subsequently proven that he had done so; that all meetings of the oil companies had been informal and inconclusive; that any decisions reached had been nonrestrictive and, in any event, not applied at any time; and that he had heard the term "as is" for the first time at this meeting. Texas at both meetings stated that it has participated in informal discussions and understandings to bring about "sounder conditions" in the trade and a normal "profit," but denied that the "as is" agreement had been applied.

The representatives of all companies agreed that the oil trade in Sweden had always been *"free,"* that competition had always been keen with respect to *qualities and service*, and that such agreements as had been made were designed to *maintain "order"* and to prevent *"ruinous prices."* They agreed further that these agreements were never observed. [Italics added.]

together with rebutting comments by the committee.[16] The numerous objections advanced by the companies were generally based upon a complaint that the committee had in one way or another exceeded its authority and upon the argument that the facts adduced and documented by the committee had been given an undue and unnatural interpretation.

Statements of Standard (New Jersey) and Gulf. The Standard (New Jersey) subsidiary claimed that the committee exceeded its authority in that (1) the report gave "the impression of a court proceeding" in which the committee members "appear before the reader as both prosecutor and judge in one person. Such a method cannot be in accord with the meaning of the law"; (2) it was contrary to the spirit of the law to make public letters, records, and other documents of private business, including those containing "statements of terms with given companies or persons;" these parts of the report could only cause economic harm to the companies and were not necessary in the execution of the committee's task; (3) the report was "unnecessarily verbose" and it would be difficult for the public to understand its actual contents; (4) the committee "should continue itself to, what is necessary for accomplishing the aims of the investigation—i. e., an objective and factual statement—without unnecessary accounts of the cooperation that has actually taken place on the *Swedish oil market* during a given period, omitting all irrelevant material * * *";[17] i. e., the committee should discuss only the economic results of this cooperation [18] without disclosing the form or the extent of the cooperation that had taken place.

The position of the Swedish Gulf Oil Co. was that no "agreements for intimate cooperation" had been "entered into", that no "monopolistic tendencies" had been "approved," that competition had been keen for a long time, and that no complaints were justified since "such meetings as had occurred * * * did not result in disadvantageous or unfair conditions for the consumers of petroleum products."

Gulf's arguments may be summarized as follows: (1) Much of the report—i. e., that part dealing with events up to the spring of 1937—is of merely historical interest since it deals with the special circumstances surrounding the participation of the Naftasyndikat (owned by the Russians) in the market. This period ended when the Gulf Oil Co. acquired Nafta's business.[19] The Nafta period was characterized by Gulf as being one of price wars and of financial losses. (2) Gulf denied that it had engaged in any improper activities after the close of the "Nafta period," defending many specific events and practices; e. g., it contended that the exchange of sales information among the oil companies had produced "helpful sales figures from a statistical viewpoint" but that "there has never been any question of the companies dividing the business between them." (3) Gulf defended its conduct and that of the oil companies as customary and ethically justifiable. Thus, it asserted that the almost weekly meetings of representatives of the oil companies during 1938–40 were neither "illegit-

[16] As an addendum to ch. XII of Swedish Report.
[17] Italics added.
[18] I. e., prices and sales conditions. See p. 280, footnote 15.
[19] Gustaf Dahlborn, who had been an official of Nafta from the time it was founded by the Russians in 1928, continued as managing director of Swedish Gulf and held that office at the time of the investigation. For comments on this "Nafta period," see above, p. 282, footnote 23.

imate" nor "harmful." They have only been honorable, concerted, usually unsuccessful attempts to bring a bit of system and order in the petroleum market." (4) Finally, it contended that the report must not be published, not only because it would give the public a false impression of the oil business in Sweden—"it presents an entirely biased and extraordinarily misleading picture"—but also because it dealt with a question which should not be settled by public opinion nor "exploited for articles on the front pages of newspapers." Gulf's opinion was that decisions with regard to the future of the oil business in Sweden should be made upon "factual conditions as they exist today," and with regard only to "practical matters." "Theoretical speculations and political viewpoints" should be left aside, and decisions should not be made by "the public" or by "a so-called built-up opinion."

Gulf put its case in these words:

Hitherto, to the best of our knowledge, it has never been considered reprehensible for businessmen within a particular business to meet for discussions of mutual interests for the purpose of bringing order in the market. *Insofar as the oil companies have tried to realize a somewhat uniform price level, the elimination of extra rebates, a reduction of the number of distributing points, etc., all this must be considered permissible and reasonable* * * * If in one point or another there has been achieved a regulation, it has never been unfair or uneconomical for the consumers. *Considered objectively, it can never be wrong to maintain uniform prices and conditions for gasoline which for the most part is a standard product.* Had the prices been set too high, or if any other criticism were to be made about the other conditions, then there would be an excuse for fault finding.[20]

Statements of the other companies. The arguments advanced in the statements of the managing directors of the other companies included an attack on the committee's power to make its investigation and a blanket denial of the committee's conclusions.

Shell argued that the basic law under which the investigation was conducted authorized investigations only where "an enterprise or an association * * * can be assumed to be of a monopolistic nature." In this view the committee was obliged to prove, first, that the oil companies formed an actual "association" rather than a mere group of companies, and, second, that such an "association" was of a monopolistic nature. Shell argured that the committee had not successfully proven either of these two points,[21] and hence no further investigation was permissible.

Anglo-Iranian (BP) contended that the most important fact about the agreements was that they had not been observed.

Anybody reading this selection (of documents) must primarily come to the conclusion that some kind of trust had been created, whereas the real situation was that, though the companies only *sought through cooperation to bring some measure of stability to the price structure of the oil market*, they nevertheless came to grief time after time.[22]

The Texas Co. stated that the most important duty of the committee

[20] Addendum to ch. XII, p. 14. [Italic added.]

[21] Shell charged the committee with being tendentious in that it gave a different meaning to cooperation in the oil industry than it really had—"those concerned have tried to prove the existence of agreements between the companies, though, as a matter of fact, there have been no such agreements"—and in that it reported only the material "calculated to place the oil companies in an unfavorable light." Shell also argued that such cooperation as had taken place was legal and no different from that occurring in most of the other branches of Swedish industry.

[22] [Italics added.] In omitting this point, BP argued, the committee's selection of documents for quotation and its statements of findings were "one-sided," and were designed to create "distrust of business undertakings in this branch of commerce."

was to determine whether or not a monopoly existed in Sweden "today" (1947). Since the committee had really discovered at an early stage in its proceedings that such was not the case, Texas said, it should have confined itself to establishing this conclusion. Thus the committee had exceeded its powers and issued a report that was "pure propaganda," since it presented an "exaggerated" account of irrelevant matters.[23] Texas then asserted that

"the actual fact was that *during the whole period mentioned, there has been an intense and continuous competition between the companies.*" [24]

Nynas confined its statement to an assertion that the statements made by its officials to the committee were "confidential" and hence "not suited for publication."

Comments of the committee. For the most part, the committee denied the validity of the arguments advanced by the oil companies, simply stating that they were refuted by the contents of the report. Among the more important points made in its comments are the following: (1) There was no justification whatever for the argument that the committee had exceeded its authority.[25] (2) The selection of material for the report was not tendentious, as had been claimed, but rather reflected the fact that "*both the extent and the forms of the companies' cooperation have essentially differed from what the companies' representatives have stated to us.*" [26] (3) Assertion by the companies that it was not proven in the report that agreements had ever existed, or that an "association" of the companies had even been established, and so on, were rejected. "It is impossible to attach any importance to it." (4) The committee rejected the argument that it should have investigated "in each individual case to see whether the decisions had been put into effect." [27] To this the committee remarked that such an investigation was unnecessary since it assumed that those who made the decisions would not act contrary to them.[28] (5) The committee rejected the view that the contents of the report included "confidential" statements or other materials, i. e., matters of private business, unsuited for publication, as well as Gulf's view that "the public should not * * * be given the possibility of forming an opinion." The committee's view was that the public was entitled to get all the information that was available, and that the companies had had adequate notice that the results of the investigation would be published.

[23] Texas argued that the committee's intent in investigating cooperation in the industry during the previous 15 years had no connection with its legal duties, i. e., this investigation, according to Texas, did not throw light on the question of the present (1947) existence of monopoly in the trade, but rather was to produce material to support a recommendation of a state monopoly.

[24] [Italics in the original.] Cooperation in the oil trade, according to Texas, was designed merely to bring about "sounder conditions in the market," but there was no proof that it had "existed in the form suggested in draft agreements prepared." These "draft agreements," as Texas described them, were not actual agreements to be observed, it said: thus, for example, the initialing of the Swedish "as is" agreement of October 15, 1937, was intended to signify only that the representatives of the oil companies "had read the draft" and not that they had reached an agreement "binding" on the parties.

[25] The committee's powers were based on appointment by the Government pursuant to authority granted by the Rikisdag, i. e., it was a legislative committee. The committee pointed out that Brian French, a representative of the London office of Shell, agreed that, as far as he was able to ascertain, it had not exceeded its powers.

[26] Italics added.

[27] See statements of BP and Gulf.

[28] "We have presumed that responsible managers of enterprises * * * cannot proceed in such a way that they act contrary to decisions they have themselves made. In any case, such a point of view is alien to anyone who is of the opinion that *decisions made ought to be observed.* That the companies' managing directors were to hold these meetings only as an apparent maneuver with a view to misleading each other in respect of their real price policy is *an explanation that seems too unreasonable to be acceptable.*" [Italics added.]

Summary and review of the Swedish case history.—The Swedish case history has demonstrated in some detail the processes by which the local marketing subsidiaries of the international oil companies have negotiated and put into effect cartel arrangements. The major conclusions to be drawn from this case history are as follows:

(1) The oil companies participating in the cartel arrangements effectively dominated all petroleum product markets in Sweden from 1933 to 1936.[29] In each market, except asphalt, the cartel participants, including Gulf,[30] delivered in 1936 from 96 to 100 percent of the tonnage sold for domestic consumption in Sweden.

(2) The Swedish subsidiaries of Standard (New Jersey), Shell, and Anglo-Iranian, the "as is" group, participated in all of the reported negotiations, agreements, meetings, and cooperative efforts of the oil companies in Sweden during the period under review in this case history, 1930–47. Texas was an equal participant throughout this period, while Gulf was a full participant from the time it became a major factor in the Swedish market in 1937. Nynas, a Swedish concern, and Nafta, the Russian-owned predecessor of Gulf, collaborated in the main with these firms.

(3) The Swedish cartel arrangements were inspired and guided for most part by the international "as is" agreements, particularly the Draft Memorandum of Principles.[31]

(4) The cancellation of the Draft Memorandum of Principles at the end of 1937 was not intended to—and, in fact, did not—result in the termination of the local agreements, since the parent companies instructed Standard (New Jersey), Shell, and BP to continue the local agreements if possible. The five-party Swedish "as is" agreement continued until at least the end of 1938. Repeated efforts to draw up a new five-party or, failing this, three-party agreement were interrupted by the outbreak of World War II. The oil companies prepared a new price agreement after the war, which was intended to be effective on January 1, 1947.

(5) The parent corporations supervised and directed the cooperative efforts of their subsidiaries in Sweden. While the Oil Investigating Committee was able to investigate this matter in only one case, they report that "the company concerned has, with regard to cooperation with other companies, in some cases received detailed instructions from their principals, and has in turn rendered detailed reports to them and asked for their approval of what has occurred." [32]

[29] While no trade statistics are available after 1936, the following excerpts from a review of the Swedish Oil Trade in 1939 is suggestive.

"The petroleum trade in Sweden is dominated by six large oil importers, all of which, except one, are subsidiaries of foreign concerns. The five foreign companies operate under price agreements. Aktiebolaget Nynas-Petroleum practices the same price policy, although outside the cartel. It is said that these companies have 98 percent of the trade. Two other companies exist principally by utilizing the cartel's price policy to keep somewhat lower prices. They seem to be too unimportant to the other groups to start a price campaign against them, as they have only local interests.

"No division of the country into sales districts has been made; but, according to trade information, parent companies of the above-mentioned five concerns have a certain quota agreement." International Petroleum Trade, Sweden: Petroleum Survey, 1939; from a report from Stockholm of American Vice Consul Harold Carlson, July 25, 1940. September 30, 1940, p. 358.

[30] Gulf's collaboration with the cartel began at the latest in January 1936. (See above, p. 293.)

[31] The Oil Investigating Committee reported that it had evidence in its possession, which it did not disclose, that cooperation between subsidiaries of the "as is" companies of a similar nature also existed in other countries.

[32] At the meeting with the Oil Investigating Committee on November 22, 1946 (see p. 305 above) representatives of Standard (New Jersey), BP, Shell, and Gulf stated that there was a regular exchange of informtion and views between the subsidiary and parent concerns.

(6) The administration of the Swedish cartel arrangements was carried on through the medium of regular weekly meetings of the managing directors of the companies, at which all matters of common and current interest were discussed and differences of interest or interpretation were resolved through negotiations. The Oil Investigating Committee likened these meetings to "a permanently functioning board of cooperation with Shell as the executive organ." At the meetings, the companies regularly rendered audited accounts of their trade statistics; i. e., "lists of deliveries invoiced" by them.

(7) The cartel arrangements included agreements that the companies would charge identical prices and would fix uniform rebates, commissions, bonuses, discounts, and other selling terms. It was agreed that customers would be classified and that rebates, and the like, would be eliminated for some classes of special customers and made uniform for others. It was agreed that the companies would consult in advance before any firm made tenders to State institutions and other large customers. It was also agreed that the companies would "respect" each other's customers.

(8) The distinctive "as is" arrangements applied at first only to the "as is" group, but in 1937 were extended to include Texas and Gulf. Nynas did not adhere to these arrangements but cooperated in other respects. The adherents to the "as is" arrangements were assigned distribution quotas in each product market. A system of adjustment and compensation for over- and under-trading was instituted. The principal method of adjustment agreed upon was the transfer of major customers, particularly State institutions and the like.

(9) The Oil Investigating Committee found that the arrangements set forth in paragraphs (7) and (8), above, were generally adhered to by the oil companies. Price changes in the market were the result of decisions of the companies. Uniformity of prices, rebates, and sales conditions was largely achieved. Special customers were classified and their terms of sale fixed as a result of negotiations among the oil companies. Markets were divided and customers steered to the designated suppliers by a number of devices, including that of tenders at fictitious prices. Adjustments of over- and under-trading were made, often by the device of transferring customers.[33] While the companies contended that the agreements were, in effect, mere paper promises, the committee was satisfied that they had been substantially put into effect.

(10) Outside marketers, such as the consumer cooperatives and the small importers, were generally whipped into line in order to protect the interests of the oil companies, including the cartel arrangements, and the interests of the affiliated outlets. The committee reports that "decided pressure" was exerted on these outsiders to adhere to the prices and other matters in the agreements. The companies refused to do business with the cooperatives, except the IC, or proposed terms which were onerous, or required the cooperatives to limit their activities. Special efforts were made to bring the IC into cooperative agreement with the oil companies. In nearly all cases control over supplies was the chief weapon used.

[33] The committee reports that these adjustments often were submitted to the parent companies for approval. In some cases adjustments were made by special transactions directly by the home offices of the parent corporations.

(11) Since the Oil Investigating Committee was unable to obtain essential data relating to costs, it was unable to state whether prices had been unreasonable or the oil enterprises unduly profitable. According to a statement by one of the companies, benzine prices in 1939 were unduly high, but no reduction in price was made. State and municipal institutions were especially vulnerable to the cartel operations, but the effects on consumers in general could not be determined.

The above summary recapitulates conclusions unanimously arrived at by the Oil Investigating Committee of 1945.[34] The Swedish oil market was not a free market but one regulated and controlled by private arrangements. The primary task of the committee was to survey the oil trade and to submit proposals with regard to the future of that business. Among the alternatives considered was that of a state monopoly of the trade. These facts were among the important considerations that led the majority of the committee to recommend the establishment of a state monopoly.[35]

The United Kingdom of Great Britain and Northern Ireland

Standard (New Jersey), Shell, and Anglo-Iranian, through their marketing subsidiaries and affiliates, have been the predominant factors in the petroleum markets of the United Kingdom since before the First World War. These markets are of the greatest importance to the international oil companies, since they are the largest world markets outside of the United States.[36] The "as is" powers have successfully cooperated among themselves in the control of this highly concentrated market, and have been the principal means through which the oil trade has been organized in all its aspects.

Three companies, Anglo-American Oil Co., Ltd.,[37] and marketing subsidiaries of Shell and Anglo-Iranian (at that time Anglo-Persian), emerged from World War I as dominant marketers in the United Kingdom. An expert on the British oil trade described conditions at that time as follows: [38]

> Immediately after the war there was little competition from the small outside companies known in the trade as "pirates," which had scarcely had time to reestablish themselves, and the prewar companies, having become accustomed to a certain amount of cooperation with each other during the war, continued to act together in such matters as wholesale and retail selling prices, the general conditions of the trade, and its relations with dealers and the public.

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[34] Both the majority and minority of the committee agreed, for the most part, on the conclusions and facts recited in this case study. See the special statement of the minority. pp. 5–6, for their views. The minority felt that the important matter was not whether there had been cooperation among the oil companies, though they deplored the facts that had been developed and the attempts of the companies to mislead the committee, but whether or not the companies had misused or abused their power. The minority felt that the companies had been reasonable in their activities and had never "literally" applied the quotas or the "official prices."

[35] The opinion of the minority was that no economic benefits to the public would result from the proposed monopoly and that the remedy for the situation lay in increased competition by domestic concerns and the consumers' cooperatives.

[36] In the prewar period, about 30 percent or more of European oil consumption (excluding the U. S. S. R.), and about 15 percent of foreign consumption (i. e., world consumption excluding the United States and the U. S. S. R.) was concentrated in the relatively small geographical area of the British Isles (The Petroleum Times, March 5, 1938, p. 306, and February 25, 1939, p. 259). Consumption in fiscal 1949 was about 70 percent greater than in the prewar (ECA European Recovery Program: Petroleum and Petroleum Equipment, March 1949, p. 32). Although the U. S. S. R. was a greater consumer of petroleum than the United Kingdom, it is not a "market" in the ordinary sense of the word.

[37] From 1911 to 1930, Anglo-American was a legally separate corporation, but was regarded as the "representative" in Great Britain of "Standard Oil Group" interests; C. T. Brunner, The Problem of Oil, 1930, pp. 30–32. For the relations of Standard (New Jersey) with Anglo-American, see above, p. 219.

[38] Brunner, op. cit. p. 22.

The major companies fortified themselves during this period through the acquisition of some of the established firms in the British market.[39] The major companies were commonly referred to as the "combine" because of their close cooperation.[40] Because of their wide market coverage, they were also frequently called "national" companies in contradistinction to other marketers who operated on a local or a limited scale.

During these years several other firms, which were subsequently to become of national importance, entered the oil trade. The first of these was the National Benzole Co., Ltd., incorporated in 1919. National Benzole produced benzole (a motor alcohol) and marketed a blend of this product and benzine. Since it purchased its supply of benzine from Anglo-Persian, it was regarded as an associate of that company.[41] National Benzole was not a disturbing factor, and cooperated with the major companies in their control of the market.

Two other firms which were formed in the 1920's soon expanded their operation throughout Great Britain and became major disturbing factors in the market. The lesser of these firms was the Power Petroleum Co., which marketed motor spirit manufactured by cracking kerosene purchased from the Russian Export Trust.[42] The more important was Russian Oil Products, Ltd., popularly known as ROP, established in 1925 as a marketing subsidiary in the United Kingdom by the Russia Export Trust. ROP soon became the leading outsider in the British market. While ROP and Power Petroleum were both price cutters, their operations until the late 1920's were on too small a scale to cause any serious disturbance to the market.[43]

The other companies in the oil trade, known collectively as the "pirates," limited their operations to specialized or local markets. None of these companies held more than a very small portion of the total trade. Some were small but well-established British concerns and others were marketing subsidiaries of such American concerns as Cities Service Oil Co. and the Texas Co. The term "pirate" was attached particularly to a number of British firms which operated on the fringes of the industry in the large municipal markets. These marginal firms were brought into the market through three factors, the profitability of the business, the richness of the concentrated municipal markets, and the availability of supplies of gasoline, par-

[39] Shell acquired a controlling interest in 1919 in the Mexican Eagle Oil Co., Ltd. In 1920 the British marketing subsidiaries of Shell and Mexican Eagle were merged on a 50–50 basis into Shell-Mex, Ltd.

Anglo-American in 1925 acquired control of the marketing facilities of the British Mexican Petroleum Co., Ltd., another established outsider in the British market. British Mexican, which owned, in addition to its own business, the entire capital stock of the Redline Motor Spirit Co., another long established marketer, had been an affiliate of the Pan American Petroleum & Transport Co., a subsidiary at that time of Standard Oil Co. (Indiana). During the 1920's, Anglo-American also purchased Glico Petroleum Co., Ltd., which had been in the oil business since 1888, and the Agwi Petroleum Co., Ltd., a refinery company in Great Britain. In 1932 Standard (New Jersey), which had acquired control of Anglo-American in 1930, purchased the remaining British marketing interests of Standard (Indiana) together with other holdings of Pan American. These interests included the Petroleum Storage & Finance Co., Ltd., and its marketing subsidiaries, Cleveland Petroleum Products Co., National Filling Stations, Ltd., and British Oil Storage, Ltd.

Anglo-Persian in 1933 purchased Continental Oil Co.'s 90 percent interest in the Sealand Products Co., Inc.

[40] Brunner, op cit., p. 39.

[41] Ibid., p. 31. Benzole mixtures in the British Isles at the end of the 1930's generally were about 1 part benzole and 3 parts gasoline. Ibid., p. 104.

[42] The parent company of Power Petroleum, which was established in 1923, was the Medway Oil & Storage Co., which imported Russian kerosene for manufacture into benzene at its cracking plant.

[43] Ibid., p. 24.

ticularly at the public wharves near these markets. The "pirates" purchased their supplies from private brokers who had picked up spot cargoes of American, Rumanian, Mexican, or Russian oil at bargain prices, and resold them at cut prices to those dealers willing to retail unbranded products.[44] The basis for this type of marginal operation, therefore, was the availability of cheap surplus supplies in producing areas [45] and the low prices of those supplies which made the business profitable despite the irregularity of shipments, the lack of established trade names, and the uncertainty of quality.

Cartel arrangements in the United Kingdom.—In 1929, the three major companies reached a series of agreements with most of the outside firms designed to eliminate price cutting and other harassing tactics.[46] In the first of these agreements,[47] concluded on January 1, 1929, the independents, i. e., most of the substantial and established outside companies except ROP agreed to adopt the price schedules and marketing practices of the combine. The independents agreed to sell only to "legitimate" retailers "approved" by the Motor Agents' Association,[48] and to recognized "commercial customers." They agreed to adhere to the wholesale prices and to the schedules of prices to commercial customers [49] fixed by the national companies, i. e., the combine, and to observe the geographic zoning scheme they had determined. They agreed to require their retail customers to maintain prices at the levels fixed by the national companies; the provision actually was that the independents would cause their retail outlets to maintain the same rate of profit as that allowed by the national companies. Since wholesale prices were to be uniform, this would make retail prices also uniform.[50] They agreed to cause their retail outlets to gradually eliminate all unbranded pumps and the like, so that all pumps would be marked clearly with the brand name and grade of the product dispensed therefrom. With the brand and grade posted on the pump, it was easier to identify price cutters and those selling the odd lots and off-brand gasolines distributed by the "pirates." The national companies, on their part, agreed, insofar as the parties to the agreement were concerned, to stop their policy of discriminat-

[44] Ibid., p. 23.

[45] Brunner attributes the availability of this cheap oil to overproduction by many small producers in the United States and Rumania and the high rate of bankruptcy among these concerns; ibid., p. 35. For further discussion of overproduction in the late 1920's see chapter VIII.

[46] These agreements were precipitated by the imposition of additional petrol taxes in April 1928, which made the public price conscious. As a result the sales of the price-cutters, ROP, Power Petroleum, and the "pirates" boomed, and British prices failed to rise in 1928 along with world prices. Prior to this time the combine had limited its attacks on outsiders to a "fierce" newspaper campaign in 1927 on "Russian" oil, i. e., ROP and Power Petroleum. This tactic was unsuccessful. Brunner, op. cit., p. 24.

[47] Information about this agreement and the related agreement between Power Petroleum Co. and the combine is taken from Brunner, op. cit., pp. 39–41. In the late 1930's Brunner, an Englishman, wrote two books about various economic aspects of motor transportation, and also the book cited here on the oil trade in the United Kingdom. This book was intended to explain the economics and history of the oil trade and was written from the industry or trade association point of view. He approved of cooperation among the oil companies, and saw the activities of the "combine" as "the only safeguard of the retailer against unorganized cut-throat competition." Ibid., p. 39. It is not known, however, what sources of information were available to him and hence his account may not be complete or accurate in all details, and the Federal Trade Commission does not vouch for such details.

[48] The Motor Agents' Association "approved" only of garages and filling stations as retailers. It was formed by distributors to protect the retail trade in new and used cars, garage supplies and services, and the like, in all its interests except prices.

[49] Including special rebates to large customers.

[50] It is not clear what sanctions the independents were to apply to enforce this uniformity among their retail customers. The national companies had an agreement with the Motor Trade Association—a similar organization to the Motor Agents' Association but solely concerned with retail price maintenance—to cooperate in their activities by cutting off supplies to retailers whom the MTA identified as price cutters.

ing against retailers who sold independent brands. In the United Kingdom it was customary for retailers to sell the brands of all leading companies. It had been the practice of the national companies to pay loyalty rebates to retailers who sold only national brands, a kind of exclusive dealing arrangement. These discriminatory payments were now extended in favor of those independents who entered into the agreement.

The Power Petroleum Co. not only was a party to the above agreement but also made a separate agreement with the combine on the same day. Power Petroleum, which drew its entire supply from the Russians, agreed to set aside 5 percent of the f. o. b. prices paid to the Russians, to be paid as compensation to the owners of expropriated Russian oil interests.[51]

In March 1929, the combine, acting through Anglo-American, concluded a related agreement with R. O. P., the most important outsider in the British market. R. O. P. agreed to sell to the three major oil companies—Anglo-American, Shell, and Anglo-Persian—an undisclosed volume of refined products annually,[52] the prices to be charged for these products to be fixed at 5 percent below current market prices.[53] Other provisions of the agreement are unknown but were reported to be restrictions on Russian trade in the British market.[54]

It seems evident that the purpose of this agreement was to adjust R. O. P.'s participation in the British market.[55] The London Economist described the principal purpose of the agreement as one "fixing its [the Russian] proportion of the British trade." [56] Sir Henri Deterding, of the Royal Dutch-Shell group, issued the following statement at the time the agreement was concluded:

> The new agreement put an end to the dumping policy of Russia, and the acknowledgment of the compensation principle has created a base for new relations.[57]

One immediate result was a rise in the prices of petroleum products.[58]

With the conclusion of these agreements in 1929, the national companies had completed a structure that formed the basis for the control of the English oil trade until the outbreak of World War II. The only firms outside this structure of control were the remaining "pirates" who were dependent on spot cargoes for their supplies, were discriminated against by the "loyalty" rebates and other control devices, and, in any event, were too small to disturb the market seriously.

In 1929, the national companies also broadened the scope of their long-established close cooperation in the English market by negotiating an agreement which applied the "as is" principles that their parent

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[51] It is self-evident that the Russians must have consented to this agreement.

[52] This sales agreement, or successors to it, apparently continued in force at least until the beginning of World War II; Moody's Industries, 1940. Jersey Standard acquired this contract in its purchase of Anglo-American in 1930.

[53] This was in lieu of the payment of 5 percent of the value of the f. o. b. purchases of the major companies to expropriated owners of Russian oil properties. A report in the Petroleum Times, April 27, 1929, p. 744, to the effect that no provisions in the agreement provided such compensation therefore, does not exactly state the case.

[54] Brunner, op. cit., p. 41. These restrictions may well have been similar to those set forth in the agreement made 2 months before, according to Brunner, with most of the independents. According to the Oil and Gas Journal, June 2, 1932, p. 20, R. O. P. agreed to a price-maintenance scheme and was allowed a fixed gallonage in the United Kingdom market.

[55] However, Russian exports to the British market continued to expand until 1931, thereafter falling to a fixed proportion of British imports. This, however, reflects R. O. P.'s position as a supplier rather than as a distributor in the British market; see below, p. 319, footnote 74.

[56] December 31, 1929, p. 1196.

[57] The Petroleum Times, March 16, 1929, p. 466.

[58] Ibid., p. 473.

concerns had negotiated in 1928. While the details of this British agreement are not known, it was reported that its provisions included agreements on prices and on the limitation of pump installations in the United Kingdom.[59] It may be supposed that this agreement generally followed the provisions of the international agreements with regard to distribution quotas and the like.[60]

Although the structure of control put together in 1929 was subject to severe stresses during the early 1930's, it was strengthened considerably beginning in 1936. In that year, the independent distributors formalized their relations by organizing the Independent Petroleum Federation. Its membership rapidly increased from 22 to 44, comprising almost all of the independent distributors. The principal purpose of the Federation was to enforce "uniform marketing arrangements" for gasoline and kerosene, i. e., to carry out, for the most part, the 1929 agreement with the national companies. The provisions of the agreement included stipulations with regard to uniform prices, uniform commercial rebates, zoning arrangements, and the like, the purpose of which was to ensure that the price fluctuations of the national companies would be followed "exactly." [61]

It was, of course, difficult to deal with price-cutting and other competitive practices on the retail level.[62] The desirability of a strong program of retail price maintenance as a support to the whole structure of prices in the petroleum industry was regarded as evident. The national companies were strong enough to protect retail prices of their products by their own efforts; upon a complaint of price cutting they immediately cut off the supplies of the offending retailer. Instances of price cutting were reported to the national companies by the Motor Trade Association—an association of interested parties in the various branches of the retail motor trade whose function was to "administer the price protection arrangements made between the various branches of the industry."

After lengthy negotiations, the national companies [63] in 1936 became members of the Motor Trade Association; it was agreed that the association would maintain a "segregated stop list" of all price-cutters, and that the distributor members of the association would not supply any firm on this list. It was anticipated that the association would be able to induce the independent distributors, many of whom were members of the association, to support the "stop list" also. Thus,

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[59] The London Economist, December 21, 1929, p. 1197.

[60] This is probably the National Companies' Percentage Agreement, which was in force until December 31, 1934; see below, p. 317, footnote 70.

[61] The Petroleum Times, weekly issues of January to July 1939, especially January 14, 1939, pp. 41–42, and July 29, 1939, pp. 136, 141, 155; see also ibid., January 9, 1937, p. 38.

The only important firms outside the association in 1937 were R. O. P., the Texas Co., and Trinidad Leaseholds, Ltd., which had lately entered the market.

Sanctions to enforce the rules of the federation were instituted by agreement with the importers of petroleum products. The latter firms organized a body known as the "Authorized Importers." It was agreed between the two organizations that the "Authorized Importers" would sell only to members of the Independent Petroleum Association while the latter bound themselves to buy only from the Authorized Importers. It was reported that a number of cases of price-cutting had been reported to the Independent Petroleum Association, which had referred the cases to the importers' group. The latter had immediately cut off deliveries to the offenders. It was planned to put into supply contracts provisions for their termination when a distributor left the federation.

[62] The following discussion is based upon the Petroleum Times, July 17, 1927, p. 81, July 9, 1938, p. 41, July 16, 1938, p. 73, February 18, 1939, p. 206, and March 11, 1939, p. 325.

[63] The national companies, represented by the Petroleum Distribution Committee, at this time included all marketing subsidiaries and affiliates in the United Kingdom of Standard (New Jersey), Shell, Anglo-Iranian, the National Benzole Co., and Power Petroleum Co.

the price-maintenance program of the national companies was to be extended to the independents. The association, on its part, readily undertook to maintain the "stop list," and announced, early in 1937, that it would "conduct an intensive campaign to trace and put a stop to the cutting of petrol prices." In this campaign the association was fortified by a decision of the highest court in the United Kingdom, which affirmed the power of the association to discipline its members.[64] It was expected, therefore, that the association would be able to fine or suspend distributor members who failed to observe the "stop list."

This campaign failed despite the fact that "hundreds" of cases of price cutting were dealt with. The national companies charged that, while they had loyally supported the "stop list" and had lost considerable business and incurred public disfavor as a result, the association had been unwilling or unable to penalize those independents which had not done so. The national companies therefore withdrew from the association in 1938, affirming their loyalty to the "principles of price maintenance." Thereafter, the national companies continued to protect the retail prices of their brands on their own account and invited the cooperation of others. While negotiations to heal this breach between the association and the national companies continued for more than a year, nothing apparently came of them.[65]

The system of control over the British petroleum trade, therefore, was nearly complete on the eve of World War II. At the center of this system were the national companies—particularly Standard (New Jersey), Shell, and Anglo-Iranian—which together were the predominant element in the industry. These companies had cooperated closely since the First World War and, in fact, were described as a "joint venture" by one Standard (New Jersey) official. Among themselves they determined a common price and industry policy and applied the "as is" principles set forth in the international agreements.

The cartel structure of 1929, as broadened and strengthened in the late 1930's, was built by the national companies on the solid base they provided. The independent distributors were drawn to conform to the pricing and trade policies of the national companies. While complete control over prices and trade conditions in the retail trade was not attained, the partial success in this direction was due almost wholly to the power of the national companies. Such was the history of cooperation and control in the English petroleum trade immediately prior to World War II.[66]

[64] The Motor Trade Association laid the basis of its control by successful price-maintenance enforcement in other branches of the motor trade, particularly in the retail sale of new and used cars. In the well-known case, *Thorne* v. *Motor Trade Association*, the House of Lords, on appeal, sustained the power of the association to enforce two of its rules. One of these rules forbade any member of the association to supply, either directly or indirectly, any trade goods to a firm on the stop list except under preexisting contracts. The other rule provided that the price protection committee could put a member violating MTA rules on the stop list, in effect barring the member from the trade, or require the member to pay a fine in lieu of this penalty. Thorne, after being warned, continued to supply a retail customer who had been a price cutter and whose name was on the stop list. The association ordered Thorne to pay a fine on penalty of being put on the stop list himself. (The amount of the fine was not stated, but in previous cases fines had been as high as £5,000.) The law lords upheld the association in this action, declaring it to be in furtherance of "lawful business interests" (*Thorne* v. *Motor Trade Association*, The All-England Law Reports, 1937, vol. 3, London, pp. 157–172. Also reported in the London Times, June 4, 1937, p. 4). This decision gave the association effective sanctions in support of its price-maintenance program.

[65] The members of the Independent Petroleum Federation agreed unanimously in 1939 to support moves by retailers to establish a program of retail price maintenance (ibid., July 29, 1939, p. 155).

[66] For a discussion of wartime controls see pp. 266–268.

TABLE 17.—*Distribution quotas in the United Kingdom,[1] as determined in the base year, 1928, and as revised, effective Jan. 1, 1936*

[In percentages]

Product market	Standard Oil Co. (New Jersey)[2]	Shell BP[3]	Total "as is" group	Others
Base year (1928) distribution quotas:				
Benzene	28.67	57.75	86.42	13.58
Kerosene	43.43	42.37	85.80	14.20
White spirit	44.19	51.28	95.47	4.53
Gas oil	58.47	27.29	85.76	14.24
Fuel oil	15.65	79.60	95.25	4.75
Asphalt	7.25	85.94	93.19	6.81
Distribution quotas effective Jan. 1, 1936:				
Benzene	28.78	52.32	81.10	18.90
Kerosene	40.75	40.75	81.50	18.50
White spirit	37.42	42.58	80.00	20.00
Automotive gas oil	32.64	59.36	92.00	8.00
Gas oil	54.65	25.15	79.80	20.20
Fuel oil	15.43	78.47	93.90	6.10
Asphalt	13.30	68.70	82.00	18.00

[1] Including Irish Free State.
[2] Anglo-American Oil Co., Ltd., and its subsidiaries and affiliates.
[3] Royal Dutch-Shell and Anglo-Iranian Oil Co., Ltd., held combined quotas for all their marketing subsidiaries and affiliates.

Operations under "as is" and other cartel arrangements.[67] The base year, 1928, was described by an English oil trade expert[68] as one of acute competition in the industry, during which such price cutters as R. O. P. and the "pirates" made "considerable headway." Nevertheless, despite these losses, the national companies had an excellent performance in the market, accounting for 85–95 percent of the sales of each of the main classes of petroleum products. This accomplishment was reflected in the distribution quotas that were fixed for each of the product markets upon the percentage shares of the companies during this "qualifying" period as shown in table 17. These base year quotas remained in effect thereafter with few changes.[69] The quotas were subjected to a general revision,[70] effective January 1, 1936, bringing them into a closer relation to the companies' actual performance in the market. The revised quotas, shown in table 17, reflect the relative stability of the share of the national companies in the British market, since they were fixed at levels that were only moderately lower than the "base year" quotas.

[67] Except where otherwise specified, the data in this section and in tables 17, 18, and 19 are taken from Standard Oil Co. (New Jersey) documents, "Deliveries Into Consumption—Europe."

[68] Brunner, op. cit., p. 24.

[69] The quotas were changed, effective January 1, 1932, when Standard (New Jersey) acquired the British marketing subsidiaries of Standard (Indiana), and effective January 1, 1933, when Anglo-Iranian bought the British marketing interests of the Continental Oil Co.; see above, p. 312, footnote 39. In each case the distribution quotas of the parties were increased by a few percentage points. The only other change in the quotas occurred when Texas entered into "as is" arrangements in the asphalt market, being given a quota of 3.20 percent, effective August 1, 1932. Texas withdrew from this arrangement on December 31, 1933.

[70] The distribution quotas for benzene were subject to the national companies' percentage agreement up to December 31, 1934. This agreement is probably that concluded by the companies in 1929 and provided the local British arrangements under the "as is" principles. The base-year quotas, modified as described in the preceding footnote, were reaffirmed, effective January 1, 1935. It may be surmised that this technical abrogation and reinstatement of the quotas reflected the conclusion of a new British agreement under the Draft Memorandum of Principles.

TABLE 18.—*Deliveries into consumption of "controlled" products in the United Kingdom, 1928 and 1935* [1]

[In metric tons]

Marketing subsidiaries of—	1928		1935	
	Tons	Percent	Tons	Percent
Standard Oil Co. (New Jersey)	1,489,994	29.39	2,104,831	28.23
Shell/BP [2]	2,981,594	58.80	4,054,529	54.38
Total "as is"	4,471,588	88.19	6,159,360	82.61
Russian Oil Products, Ltd	229,528	4.53	216,885	2.91
The Texas Co	35,366	.70	144,446	1.94
Cities Service Co	39,538	.78	39,384	.53
National Benzole Co., Ltd	38,378	.76	110,513	1.48
Trinidad Leaseholds, Ltd			260,787	3.50
All others	256,153	5.04	524,053	7.03
Total market	5,070,551	100.00	7,455,428	100.00

[1] Includes Irish Free State. "Controlled" products include all petroleum products sold for domestic consumption except lubricating oils and specialty products. "Own use" of the companies is included except that consumed at refineries.
[2] Combined sales of all marketing subsidiaries and affiliates of the Royal Dutch-Shell group and Anglo-Iranian Oil Co., Ltd.

A summary statement of the position of the principal marketers of the United Kingdom in 1928 is shown in table 18. In that year, the national companies held 88.19 percent of the total domestic petroleum market, while the only outsider of consequence was Russian Oil Products, Ltd., which held 4.53 percent.[71] In the years following 1928, the national companies were successful in maintaining their positions in most British petroleum markets.[72] The position of the principal British companies in 1935 [73] is also shown in table 18, indicating that the national companies had slight decreases in their percentage share in the market, but with the increase in petroleum consumption, also showed substantial increases in their volume of trade. Moreoever, no

[71] Included in "all others" for 1928 in table 18 are the two firms purchased in 1932 and 1933 by Standard (New Jersey) and Anglo-Iranian. These two firms together accounted for 1.46 percent of the total market in 1928 and had nearly tripled their combined positions by 1931.
[72] In 1929, the national companies held 85.66 percent of the total petroleum trade, in 1931, 80.88 percent, the lowest position of the major companies, in 1934, 82.18 percent, and in 1936, 81.65 percent.
[73] 1935 was taken in preference to 1936 in table 18 because the data for the independent companies were not broken down in the latter year.

independent company held more than a very small fraction of the trade.[74]

TABLE 19.—*Changes in wholesale prices for motor gasoline in the United Kingdom, 1930–1939*

[Net price per Imperial gallon]

Date	Wholesale price s.	d.	Time interval	Date	Wholesale price s.	d.	Time interval
			Months				*Months*
Oct. 21, 1930	1	3		Mar. 22, 1934	1	4	5
Mar. 3, 1931	1	1½	4½	May 1, 1935	1	5	1
Apr. 28, 1931	1	3½	2	Jan. 14, 1937	1	5½	20½
May 22, 1931	1	2½	1	Feb. 12, 1937	1	6	1
July 18, 1931	1	1½	2	Apr. 27, 1937	1	6½	2½
Sept. 11, 1931	1	3½	2	July 29, 1937	1	6	3
Sept. 14, 1932	1	6½	12	Feb. 18, 1938	1	5½	6½
May 17, 1933	1	4	8	Mar. 4, 1938	1	5	½
Nov. 3, 1933	1	5	5½	Nov. 1, 1939	1	5	20

Source: The Petroleum Times, Oct. 2, 1937, p. 432, and subsequent issues to November 1939.

One more important fact about the British market in these years remains to be noted—the remarkable stability of prices during the decade of the 1930's. As will be noted in table 19, which shows all

[74] It was stated by Mr. Orville Harden of the Standard Oil Co. (New Jersey) that there had been two successful invasions of the British markets where outsiders had taken "a substantial portion of the market." The first of the invaders was the Russians, in 1927 and after, and the second was Trinidad Leaseholds, Ltd., in "approximately" 1936. Joint hearings on the Foreign Contracts Act, op. cit., p. 149. As is shown in table 18, the Russians had gained a position of only 4.53 percent of the total market in 1928. They reached a peak marketing position in 1931 of 5.25 percent, and thereafter their share of the market declined. Mr. Harden may have had in mind, however, the position of the Russians as suppliers rather than as distributors in the British market, for they supplied not only their marketing subsidiary, R. O. P., but also other British distributors, and also sold products to the national companies under the agreement of March 1929. The Russians also supplied such commercial customers as municipal gas works and the like.

The table attached to this footnote shows Russian imports into the United Kingdom, 1929–39. Imports in 1929 were said to be greatly increased over those of earlier years. It may be observed that, beginning in 1933, these imports were fixed in a low and fairly constant proportion to total British imports; these imports probably reflect fairly well the Russian marketing position after 1933 as well.

As to Trinidad Leaseholds, the following facts are known: (1) TLL (Trinidad Leaseholds, Ltd.) participated in the years prior to 1936 in "as is" and "pool" cartel arrangements in the Caribbean area; see pp. 340–341; (2) TLL drew a substantial portion of its supply from 15 percent royalties paid to it by Standard Oil (New Jersey), which managed the North Venezuelan Oil Co., Ltd., properties owned by TLL; (3) in 1936 TLL and Shell, later joined by Anglo-Iranian, formed a joint exploration and exploitation company, Trinidad Northern Areas, Ltd. In view of these close ties with the major international oil companies, it seems unlikely that TLL would pursue a vigorous program of price cutting in the United Kingdom, a principal market of the major companies.

Imports of petroleum products into the United Kingdom from Russia, 1929–39

[In thousands of Imperial gallons]

Year	Volume of imports	Percent of total imports of crude oil and refined products into the United Kingdom
1929	200,000	9.2
1930	264,431	11.0
1931	270,929	12.3
1932	167,715	7.6
1933	74,249	3.0
1934	65,743	2.4
1935	79,642	2.8
1936	80,717	2.8
1937	85,697	2.8
1938	79,982	2.5
1939 (6 months)	32,696	1.9

Source: The Petroleum Times, Feb. 27, 1937, p. 278, Jan. 29, 1938, p. 134, Jan. 28, 1939, p. 126, July 22, 1939, p. 113.

changes in the wholesale price of motor gasoline during this period,[75] wholesale prices in the United Kingdom changed only 17 times during the period of just over 9 years. Five of these changes occurred in 1931, probably reflecting competitive disturbances in the market. The six changes in 1937–38 reflect substantial increases in the United States Gulf export price of gasoline and in tanker rates from the Gulf to the United Kingdom—the two principal components in the cost of British gasoline—and their subsequent substantial decline.[76] Other than this price changes occurred about once a year, while there were two periods of 20 months with no price changes.

Summary.—The stability of gasoline prices in the United Kingdom reflects the solidity of the structure of control that had been erected there between 1928 and 1939. The long-term cooperation of the national companies—Standard (New Jersey), Shell, and Anglo-Iranian—and their predominance in the market provided the core of this control. Built around this core, and supported by it was a scheme of control that may be likened to private licensing of distributors and retailers, although the scheme was less successful in the control of retail trade. The national companies applied the "as is" principles among themselves, and these principles were, in effect, transmitted to the independent distributors through modified cartel-like arrangements. Except for sporadic rivalry among retailers, resulting largely from the activity of the "pirates," price competition had been almost completely eliminated from the petroleum industry by the latter thirties.

France

The French marketing subsidiaries of the international oil companies encountered unique problems in the application of "as is" principles. These problems arose out of the interplay of French politico-military, currency, and foreign-trade policies.[77] The effect of these policies, together with the growth of an indigenous cartel system, provided a substantial control over the oil trade, although from the point of view of the major companies, there were serious leakages in the system.

Although France consumed only 55 to 60 percent as much petroleum products as the United Kingdom, it stood next to that country as a major oil market. A substantial interest in the French market was

[75] ROP shaded these and retail prices as a matter of policy but had only a small portion of the market. Trinidad Leaseholds, Ltd., shaded the wholesale prices, but controlled retail prices for its products at the levels fixed by the national companies. See weekly section on prices in the Petroleum Times, 1936–39.

[76] While British prices are said to be based on these components of cost, actually their reaction to fluctuations in them are slow and of much smaller amplitude. In the 4½-year period, 1935 July 1939, for example, British net retail gasoline prices, i. e., wholesale prices as given in table 19, plus 1 penny and less taxes, changed seven times. The ratio of the lowest price in this period to the highest was 1 : 1.28. The United States Gulf export price in this period changed 51 times and the ratio of the lowest to the highest price was 1 : 1.53. The average monthly United States Gulf-United Kingdom clean tanker rates changed each month but three during the 4½ years, and the ratio of the lowest to the highest price was 1 : 3.18. Computed from data in the Pettroleum Times, July 15, 1939, p. 69.

[77] French petroleum policies during the interwar period were determined by the following considerations: (1) The fact that France was almost wholly dependent on foreign sources for its supplies of crude oil and refined products Various politico-economic-military problems were involved here, including (*a*) fear of blockade during wartime, (*b*) fear of being pinched in times of world shortages, and (*c*) fear of being subject to the control of petroleum monopolies or of foreign governments. (2) The fact that foreign currencies were required to purchase the needed supplies. Involved here were French monetary problems of the interwar period, and the problems of the determination of prices and of rates of exchange. See "French Petroleum Policy of 1937," by R. Ramadier, The Petroleum Times, June 12, 1937, pp. 766–767. A further consideration, related to the above, was probably the desire to protect and expand domestic industry and trade.

held by four international oil companies—Standard (New Jersey),[78] Royal Dutch-Shell, Anglo-Iranian, and Socony-Vacuum Oil Co., Inc.—which, as in other countries, cooperated in the application of "as is" principles.

French petroleum policies.[79]—French petroleum policies during the interwar period were based on two laws of March 1928. One of these laws provided that only licensed firms would be permitted to import petroleum products.[80] Small importers, i. e., those importing less than 300 metric tons per year, were required to obtain licenses, but were exempted from most other provisions of the law. Large firms, i. e., those importing 300 metric tons per month or more, were subject to quota restrictions; they received 3-year renewable licenses permitting each to import only specified ratios of the total import trade in certain products.[81] These quotas were determined by the Government on the basis of the actual performance of the licensee in the market, and were reviewed at 6-month intervals so as to keep the companies "in balance," i. e., so as to preserve the relative positions of the companies in the import market. Import licenses were granted to 46 distributors in March 1929. The purpose of the law was said to be to achieve the twin goals of protecting established interests in the trade and of protecting the public against the development of excessive controls by foreign "combines."[82]

The second of these laws provided for stiff increases in import duties on refined products, its purpose being to "revive" and develop the French refining industry.[83] Further measures to support this policy were taken in 1931, when it was provided that import authorizations, good for 20 years, would be issued to those concerns agreeing to erect refineries in France.[84] It was anticipated that these refineries would handle, as it became available, allotted quantities of the crude oil obtained under the French interests in Iraq.[85] In all, 10 such

[78] The principal French interests of Standard (New Jersey) are in the United Petroleum Securities Co., which is owned by Standard (67.5 percent), Gulf Refining Corp. (22.5 percent), and Atlantic Refining Co. (10 percent). United holds an 81.54 percent interest in Standard Francaise des Petroles, a marketing company. American firms in the French market, other than those previously mentioned, included the Texas Co. and Sinclair Oil Corp.

[79] This section is taken mainly from the following sources: The Petroleum Times, April 10, 1937, p. 483, and June 12, 1937, pp. 716-717; report of the Oil Investigating Committee of 1945 (Sweden), ch. IV; and joint hearings on the Foreign Contracts Act, op. cit., pp. 142-144.

[80] An earlier law of 1925 required licensees to maintain reserves equal to 3 months' supply and to publicly post their prices as a condition for obtaining the licenses. (The latter provision was intended as a protection to the public, but it may also be a useful device for enforcement by a cartel of price uniformity.) In the law of March 1928 the reserve requirement was increased to 4 months' supply.

[81] These import restrictions applied only to the trade in benzene, kerosene, gas oil, and lubricating oils. These were the most important petroleum products in terms of volume of business and of value. All petroleum products other than those mentioned were free of quota restrictions.

[82] The rapporteur of the bill stated in the Chamber of Deputies that among the purposes of the bill were "to keep the balance equal between all; to fix each one's share in our supplies; to insure later on the placing on the French market both of our share in Mesopotamian oil * * * and of the synthetic petrol which we may tomorrow extract from our coal and lignite." He later stated that the purposes of the bill were to prevent the further development of the hold of the "combines" on the French market, and yet to protect the "vested interests" of the combines, and to establish diversified sources of oil by issuing import licenses to companies of all nations.

[83] These import duties were again substantially increased on November 12, 1938.

[84] The licensees were also required to promise to work jointly with the state in the promotion of policies declared to be in the public interest.

[85] In 1936 and 1937, 52.6 percent of crude oil imports into France were from Iraq. One of the licensees was the Compagnie Francais des Petroles (CFP), which not only held the French interests in Iraq but also was granted the privilege of refining about 25 percent of total French marketing requirements, all French distributors being required to offtake from CFP up to 25 percent of their total combined requirements. CFP was owned by the French Government, the international oil companies, and others, and was founded in 1931; see p. 54.

special licenses were issued to companies and to groups of companies. These special licenses established refining quotas which were subject to revision every 6 months. It seems probable that the refining quotas corresponded fairly well to the import quotas, not only because both were held by substantially the same groups of companies, but also because the import quotas tended to state the quantities of the permitted imports which were, in fact, to be refined domestically from imported crude. This French policy substantially fulfilled its purpose. While in 1929 only 5.8 percent of the total imports of petroleum consisted of crude oils, the proportion had risen to 83.7 percent by 1936. These figures reflect the rapid growth of domestic refining facilities and of their output of refined products.

Cartel operations in France.—The French petroleum policies furthered the growth of associations which tended to bring the more important oil companies into intimate cooperation. Nearly all of the French distributing companies of any size were joined together in the Board of Liquid Fuel Distributors.[86] This has been described as a "voluntary" group set up under auspices of the Government. Every company doing business in France in 1928 and subject to the quota system was invited to join this "syndicate," and thereafter membership was closed by a French law.[87] The function of the syndicate was to represent these companies before the appropriate agencies of Government from time to time as current problems arose. Frequently these problems had to do with prices.[88] The procedure in the syndicate was as follows: The representatives of the companies met together.

> They talked over their problems. That was the method of contacting the Government. They chose from the syndicate a president, or a small group, to confer with the Government on their problems.[89]

This intimate cooperation of the principal oil companies in France extended to the formation of cartels governing the distribution of petroleum products. Four distributors, representing about 51 percent of the trade in 1936, were bound together in the application of the "as is" principles.[90] Three of these companies (Standard (New Jersey), Royal Dutch-Shell, and Anglo-Iranian) based their quotas, as the Achnacarry agreement provided, on their market performance during 1928. Socony-Vacuum, which adhered in France to the "as is" principles, effective January 1, 1935, was allowed to take 1931 as its "qualifying period." There were no substantial changes in the base

[86] Chambre Syndicale de la Distribution des Carburants et des Combustibles Liquides. This syndicate and seven others representing the interests of the larger companies in other branches of the French oil industry were joined together in the Union of French Oil Boards, a central organ. The smaller companies were similarly organized under a central organ, the French Fuel Federation. In addition there were five other such central organizations, representing member associations of retailers and specialized divisions of the industry; the Petroleum Register, 1950.

[87] Foreign Contract Act, op. cit., p. 144. While not explicitly stated, this would imply that no quotas would be granted to new companies large enough to qualify under the quota system. While the size of the quotas that were granted were determined by the Government, the function of the syndicate was to negotiate with the Government on behalf of the French petroleum industry on quota and other matters concerning the industry.

[88] The French Government did not fix petroleum prices, but under the laws of 1928 it controlled the prices by a review of price changes. It could order the revision of any prices it found "unreasonable."

[89] Ibid., p. 144.

[90] Standard Oil Co. (New Jersey) documents: Deliveries Into Consumption—Europe.

year quotas during the period ending in 1936.[91] The distribution quotas for benzine and kerosene are shown in table 20.

TABLE 20.—*Distribution and import quotas in France for benzene and kerosene*

[Expressed in percentages]

	Base year "as is" quotas:[1] Trading results, 1928	Trading results, 1936	Annual import quotas:[2] 3 years beginning Apr. 1, 1938
Benzine:			
Standard (New Jersey)	22.18	16.04	21.94
Royal Dutch-Shell	17.23	12.55	15.34
Anglo-Iranian	10.84	7.26	10.07
Socony-Vacuum	[1] 8.23	6.54	7.92
Total "as is"	58.48	42.39	55.27
Cie. Français des Petroles			25.85
All others	41.52	57.61	18.88
Total market	100.00	100.00	100.00
Kerosene:			
Standard (New Jersey)	21.50	16.77	19.84
Royal Dutch-Shell	20.87	23.02	24.79
Anglo-Iranian	8.39	7.95	12.52
Socony-Vacuum	[1] 8.10	7.34	7.98
Total "as is"	58.86	55.08	65.13
Cie. Français des Petroles			29.93
All others	41.14	44.92	4.94
Total market	100.00	100.00	100.00

[1] Socony-Vacuum quotas were based on 1931 market performance and were effective Jan. 1, 1935.
[2] Computed from table in International Petroleum Trade, Mar. 28, 1938, p. 76.

In 1932, it is reported,[92] a cartel was formed by all of the major French companies. The members agreed upon a division of distribution facilities and upon distribution quotas. It is not known whether the "as is" quotas were supplanted by the cartel agreement or included in it. This cartel broke down by 1935, owing in part to the loophole in the basic petroleum laws exempting from quota restrictions all "small" importers whose imports averaged less than 300 metric tons per month. These small importers had increased greatly in numbers, and the volume of their imports had increased sufficiently to undermine the cartel.[93] Negotiations for a reconstruction of the cartel were going on in late 1936, according to a memorandum written by an official of Standard (New Jersey).[94]

The erosion of cartel control of the market was due not only to the exemption of small firms from quota restrictions but also to an official policy encouraging the growth of such small local firms in order to

[91] The purchase of small outsiders slightly increased Shell's asphalt quota in 1930 and Standard's asphalt quota in 1932. Further changes occurred when the "combined black oils" quotas were broken down in 1934 and 1935. In 1934 separate quotas equal to those for benzine were established for automotive black oil and it was agreed that there would be no tonnage adjustments, fines, penalties, etc., on this product. In 1935 the "combined black oils" quota was separated into two elements (fuel oil and gas oil) quotas for each being awarded on the basis of the "qualifying period" performances in the market with adjustments for the separate treatment of automotive gas oil.

[92] Report of the Oil Investigating Committee of 1945 (Sweden), ch. IV, p. 13.

[93] Keen price competition is reported to have followed the dissolving of the cartel in the Paris and other municipal markets (ibid.). Under the international agreements, the "as is" parties were free to follow independent price policies in cases where losses in market position such as those in France were being suffered.

[94] Dated October 1, 1936, and initialed "J. H. R.," the memorandum includes the benzine quotas for 1936—these differed only slightly from those for the base year—which were to be applied by the four companies, pending the determination of new cartel quotas.

"diversify" the sources of petroleum products.[95] The entry into the market not only of these numerous small firms but also of the marketing subsidiaries of the Compagnie Français des Petroles (CFP) which occupied a favored position in France, considerably reduced the percentage positions of the "as is" companies in French markets from those attained in 1928, as is shown in the second column of table 20. The "as is" companies, for example, held 58.48 percent of the benzine market in 1928 as compared with 42.39 percent in 1936, although in the much smaller kerosene market their percentage position during these years decreased only from 58.86 percent to 55.08.[96]

TABLE 21.—*Deliveries into consumption of "controlled" products*[1] *in France, 1928, 1931, 1934, and 1936*

[In metric tons]

Year	Total deliveries	Deliveries by the "as is" group[2]	
		Quantity	Percent
1928	2,054,108	1,292,881	62.94
1931	3,226,037	1,811,991	56.17
1934	3,951,556	2,104,216	53.25
1936	4,699,502	2,392,128	50.90

[1] Includes all petroleum products sold for domestic consumption except lubricating oils and specialty products.
[2] Includes French marketing subsidiaries of Royal Dutch-Shell, Standard Oil Co. (New Jersey), Anglo-Iranian Oil Co., Ltd., and Socony-Vacuum Oil Co.

Nevertheless, despite the policies favoring the small French firms and the CFP, the international oil companies managed to hold a major proportion of the total French market. As shown in table 21, the four companies in 1928 accounted for nearly 63 percent of the total volume of all of the products covered by the international marketing agreements which were sold for domestic consumption in France. Although in the following 8 years these proportions declined substantially, the four companies still held about 51 percent in 1936. In terms of actual volume the "as is" companies increased their deliveries in France by 85 percent from 1928 to 1936, chiefly in gas and fuel oils. The percentage losses of the major companies were due chiefly to their failure to capture a representative share of the great increase in sales in the benzene market, which was particularly susceptible to invasion by the small concerns.

At the same time, however, French petroleum policies operated to protect the interests of the major oil companies through the import quota system. In the third column of table 20 the annual import quotas for the 3 years beginning April 1, 1938, are shown. These quotas apparently represent the shares of total petroleum supply allotted to the companies by the Government, including both the quantities to be refined under the refining licenses and the quantities to be imported under the import licenses. While these quotas do not repre-

[95] The International Petroleum Register, 1950, lists 142 distributors in the French market. Of these, 22 were members of the Board of Liquid Fuels Distribution, the syndicate of the larger distributors, while 120 were independent firms.
[96] The percentage share of the four "as is" companies in the "combined black oils" market –i. e., the markets for fuel oil, gas oil, and automotive gas oil —was 83.41 percent in 1928, and 59.83 percent in 1936. In asphalt, the market position in 1928 was 78.41 percent; and in 1936, 82.95 percent.

sent exactly the same thing as the "as is" distribution quotas—they represent "supply" rather than distribution positions—the close correspondence of the 1938 import quotas to the base-year market positions is striking. This close relationship illustrates the Government's declared intention to preserve but not to extend the basic positions of the companies. While the strong positions of the international oil companies in the market had been eaten away to a degree, particularly in the benzene market, they received the support of the Government in preserving their historic supply positions. Thus, although there had been considerable changes in the actual market situation, the import quotas do not reflect these changes, but allot to the companies the historic positions to which, in "as is" terminology, they are entitled. To this extent, therefore, the "as is" principles and French petroleum policies had similar purpose.

Germany.—It is interesting to note that in Germany, the country where the cartel principle was brought into its earliest full development, there were no national petroleum cartels prior to the introduction of the "as is" arrangements by the international oil companies.[97] In 1928, the three major international oil companies—Standard (New Jersey), Shell, and Anglo-Iranian—which had captured control of more than 60 percent of the domestic market,[98] came to an agreement which apparently provided for the application of the "as is" principles, as will be suggested by the following paragraphs. In addition, it was reported [98] that some important German firms cooperated with the three major companies in this 1928 agreement, including the Benzoleverband, an association of distributors, and the marketing subsidiaries of Leuna and I. G. Farben,[99] which produced motor alcohol and gasoline blends.

The 1928 agreement was defended in a public statement [1] issued on behalf of the major oil companies by "Olex" Deutsche B. P., a subsidiary of Anglo-Iranian, in response to public and oil trade criticism. "Olex" denied that the German consumer was being exploited by a "close combine" of the major oil companies through inordinately high prices and onerous trade terms. It stated that, while there had been no understandings whatever among the companies prior to 1928, they had entered upon "limited arrangements" in that year in order to "safeguard" the interests of those in the oil trade and "to counteract the senseless competition" then prevalent. These arrangements, which were still in force in 1930, it said, were not a price-fixing scheme, since the parties were all free to fix their own prices. Each party was obliged, however, to give notice to the other parties to the agreement 24 hours prior to any contemplated price changes. The parties also had agreed upon a graduated system of rebates de-

[97] According to a special report in the Petroleum Times, March 15, 1930, this was the result of an agreement reached between the German Government and Herr von Riedemann, an agent of Standard (New Jersey), following World War I. It was said that Riedemann obtained an "assurance" from the Government that no "monopoly" would be formed in that country for a 10-year period. In return, he procured supplies of petroleum for Germany at a time when supplies were short and Germany was reduced to entertaining proposals from the Rumanians that a monopoly be granted to them.

[98] It was said that, in 1933, the three international oil companies owned 50,000 of the 55,000 filling stations in Germany. This was stated in an article appearing in the German oil trade journal Erdol und Teer, and translated in the Petroleum Times, December 9, 1933, p. 710.

[99] The important German distributor, Deusche Gasolin A. G., was at that time owned 50 percent by Standard (New Jersey), and 50 percent by I. G. Farbenindustrie.

[1] Translated in the Petroleum Times, September 13, 1930, pp. 429–430.

signed to "insure appropriate margins to the various classes of merchants." "Olex" stated that the big companies had "consistently" opposed any increases in these rebates.

By 1930–31, however, this 1928 agreement had been dissolved, according to Erdol und Teer,[2] owing to the development of new and disturbing problems in the German market. Among these problems were (*a*) increases in German production of crude oil,[3] (*b*) increases in the share of the market taken by the Russians, (*c*) decreases in consumption of petroleum in Germany, (*d*) the growth of "outsiders," especially in distribution, and (*e*) the consequent breakdown of wholesale prices. Thus it became necessary for the major companies to determine new quotas, more applicable to the changed situation, and to bring more of the outsiders into the cartel. Accordingly new cartels were formed for benzene and gas oil in 1932 and for kerosene in 1935.[4]

The German cartel for benzene and white spirit went into effect on September 1, 1932.[5] The quotas that were adopted were relative distribution quotas; that is, their purpose was to preserve the relative position of the members to each other rather than the relative position to the total market. Thus, the quotas fixed a ratio to which each member was "entitled" out of the combined sales of the cartel members, unlike the distribution quotas under which the cartel members were each entitled to a fixed ratio of the total market. Under the relative quotas, the amount of business to which a member was "entitled," therefore, was determined not by the size of the market, but rather by the amount of business done by the cartel as a whole.[6] Thus each member was tied to his fellows, and all were to rise or fall together.

TABLE 22.—*Relative distribution quotas for benzene and white spirit in Germany*

[Expressed in percentages]

	Effective—	
	Sept. 1, 1932	Jan. 1, 1937
Standard (New Jersey)	21.48	21.61
Royal Dutch-Shell	21.48	21.61
Anglo-Iranian	10.68	10.74
Other cartel members	46.36	46.03

The relative quotas that were adopted at the beginning of the cartel are shown in table 22. The quotas allotted to the "as is" companies totaled 53.64 percent, while the quotas of the 18 other members totaled 46.36 percent, including a quota of approximately 16 percent held by the Benzoelverband, then by far the most important outsider in Germany. These quotas were adjusted slightly from what they would have been in the base year, 1928. During the first full year of opera-

[2] See footnote 98, p. 325.

[3] This problem was settled by an agreement of the major companies to "absorb" all additional German production before selling imported products, see p. 251.

[4] No cartel was formed for the asphalt market, so the "as is" cartel arrangements prevailed for the international oil companies. The "as is" group held 52.88 percent of this market in 1928, and 78.75 percent in 1936. Standard Oil Co. (New Jersey), documents, Deliveries Into Consumption—Europe.

[5] Except where otherwise specified all information and the data for table 22 in this section on Germany is taken from Deliveries Into Consumption—Europe.

[6] Memorandum initialed J. H. R. and dated October 1, 1936.

tion, the cartel accounted for 86.85 percent of the total benzene trade in Germany, and this business was distributed among the cartel members in accordance with their relative quotas. Of those outside the cartel, Derop (the Russian marketing organization in Germany) accounted for 7.16 percent of the total trade in 1933, a second outsider, Postgeschaft, for 2.25 percent, and various others for 3.74 percent.

The outlines of the cartel changed little until the end of 1936, despite complaints that the quotas, being based on 1928, were unrealistic under current conditions.[7] Although the quotas were adjusted nine times in 4 years, the changes were minor in character. The quotas effective on January 1, 1937, after the ninth change, are shown in table 22. The more important changes occurred as a result of shifts in membership, the Russians entering the cartel in 1935, while nine cartel members had dropped out by the end of 1936. These changes did not greatly affect the proportion of the total benzene trade done by the cartel, which was approximately 84 to 85 percent during 1934–36. It appears, therefore, that the cartel had succeeded in stabilizing the proportion of the business to be done by it, and that this business was distributed among the members in accordance with relative quotas based on 1928 which remained fairly constant throughout. These results thoroughly accorded with the "as is" principle and must have been highly satisfactory to the international oil companies.

One month after the benzene cartel began its operations a gas oil cartel was formed, which apparently covered the markets for all "black oils"—gas oil, fuel oil, and automotive gas oil. Under this cartel, relative quotas similar to those awarded under the benzene cartel were determined, the three international oil companies being entitled to 93.57 percent of the total business of the cartel and the other members to 6.43 percent. Apparently these quotas were unrealistic, and the cartel was reconstituted, effective January 1, 1935, with distribution quotas based on the total market rather than relative quotas. These quotas, which were effective as of January 1, 1935, appear to be base year (1928) quotas adjusted to accord with current market conditions. These quotas were readjusted from time to time; and, effective on January 1, 1937, they were as follows:

	Percent
Standard (New Jersey)	40.22
Shell	21.97
Anglo-Iranian	10.72
Other members [1]	20.13
Nonmembers	6.96

[1] There were two "other members," Derop (the Russians) with a quota of 18.02 percent, and a firm called "Olhag," with a quota of 2.11 percent.

Although understating somewhat the actual position in the market held by the nonmembers in 1935–36, these quotas reflected fairly closely the actual division of the market.

In the kerosene market, two international oil companies, Standard (New Jersey) and Anglo-Iranian, held about 95 percent of the market in 1928 and more than 85 percent thereafter. These two firms operated under "as is" arrangements, dividing their joint business in the ratio

[7] It was complained in 1933 that the "frenzied efforts" to enforce the quotas led to market disturbances, since the principle of the quotas was that "the laggard shall be given a helping hand either by diverting business to him or by granting him pecuniary compensation." Article in Erdol und Teer, op. cit.

existing between them in 1928, namely, Standard, 73 percent, and Anglo-Iranian, 27 percent. A cartel was formed in this market, with quotas made effective January 1, 1935. The two international oil companies received a joint quota of 86.44 percent, to be divided between them on a 73–27 basis; other members received total quotas of 5.48 percent; and nonmembers were regarded as entitled to 8.08 percent of the total market. These quotas actually fell somewhat short of the actual performance of the two international oil companies, which held nearly the same share of the total market in 1935–36 as in 1928.

Thus the international oil companies achieved a fair degree of success in maintaining their proportion of the various petroleum markets in Germany, as determined by the base year, 1928. In other words, the cartel arrangements in this respect were in full accord with the "as is" principles. These quotas, based on 1928 and adjusted to meet current conditions in Germany, remained in effect at least until 1937. While the German Government came to play an increasing role in petroleum industry affairs, as it did in other industries, this fact should not be permitted to obscure the origin of the German petroleum cartel system in the "as is" principles sponsored by the international oil companies. That the German cartels were a substantial success from the point of view of the international oil companies is shown by the statistics of distribution. The "as is" group accounted in 1928 for 61.50 percent of the total trade in the products covered by the various "as is" and other cartel arrangements. In 1936 not only did they account for 60.14 percent of the total delivery into domestic markets, but other cartel members closely allied with them accounted for a further 24.50 percent.

Belgium and the Netherlands

In Belgium, as in other European countries, the three international oil companies—Standard (New Jersey), Shell, and Anglo-Iranian—not only applied the "as is" principles but also drew their most important competitors into cartel arrangements embodying these principles. However, the cartels that were formed, especially in the benzene market, ran into difficulties because of the fact that Belgium was a trans-shipping point for western Germany and other countries. Thus, there was always present in transit a substantial volume of petroleum products [8] and, while only a small part of this supply found its way into domestic consumption, it was sufficient to cause "disturbances" in the market.

A benzene cartel was formed in Belgium, with quotas effective August 1, 1930.[9] Members of the cartel included the marketing subsidiaries not only of the three international oil companies, but also of Texas Co., Sinclair Oil Corp.,[10] Atlantic Refining Co., and two other firms known as Deco, a British concern,[11] and Purfina, a domestic company. The quotas, which were fixed on a slightly different base

[8] In 1937 about 4.4 million barrels of refined products were reported in transit in Belgium, 73 percent of this being benzene. These supplies were of "varied ownership." In 1937 Belgium's total consumption was about 6.7 million barrels. International Petroleum Trade, May 31, 1940, p. 198; The Petroleum Times, January 15, 1938, p. 88.

[9] All information, including the data for the tables 23 and 24 in this section on Belgium and the Netherlands is taken from the Deliveries Into Consumption—Europe, unless otherwise specified.

[10] Sinclair—then Consolidated Oil Corp.—sold its Belgian and German subsidiaries in 1937, according to its annual report for that year.

[11] Deco was the Belgian subsidiary of Phoenix Oil Products, Ltd.

period than the usual one of the calendar year, 1928,[12] allotted 66.97 percent of the trade to the "as is" group, and 31.48 percent to the other 6 participants. In 1931, the first full year of operation of the cartel, the "as is" companies actually accounted for 64.37 percent of the trade and the 6 others for 31.28 percent.

The cartel soon ran into difficulties, however, most of which were probably traceable to the entry of small amounts of "uncontrolled" benzene into the market. As in the case of the "pirates" in the United Kingdom and the "small importers" in France, the total share of the market held by the small "outsiders" in Belgium was small, amounting to 6.16 percent in 1933, and from 4.5 to 5 percent in other years. Nevertheless Deco withdrew from the 1930 cartel in 1933 and Sinclair and Texas in 1934. Negotiations immediately began for a new cartel, the chief points of discussion being restrictions on the domestic refining industry and on prices, which, it was said, had not been "economic."[13] These negotiations culminated in a new cartel agreement which substantially restored the 1931 quotas, effective July 1, 1935. In 1936, however, only the "as is" group and Purfina adhered to the cartel arrangements, while Texas, Atlantic, and Sinclair, although nominally cartel members, did not.[14]

Cartels in the other product markets were more stable. Firms representing 100 percent of the trade in kerosene, for example, entered into a cartel with the familiar 1928 base period. The "as is" group members held combined quotas of 78.59 percent, while Texas, Purfina, Sinclair, and Deco held quotas totaling 21.41 percent. Among other adjustments in the quotas, there was one for over- and under-trading, effective January 1, 1933, which resulted in minor changes in the quotas of most of the cartel participants.[15] During 1933, however, outsiders acquired nearly 3 percent of the market, and by May 1934, both Deco and Sinclair withdrew from the cartel. Nevertheless, the cartel continued to operate, with its members retaining control of 93 to 95 percent of the market.

A similar cartel was formed in the black oils market. The members, representing 98.27 percent of the trade during the base year, 1928,[16] included the "as is" group, Purfina, Sinclair, and the Gulf Oil Corp. During the years that followed, however, a number of small domestic firms entered the trade and Sinclair withdrew from the cartel. In 1936 these outsiders accounted for 23.34 percent of the black oils business.

Two international oil companies—Standard (New Jersey) and

[12] The 6-month period, August 1, 1927, to January 31, 1928, was the "qualifying period" The "as is" parties, however, adjusted the quotas awarded to them so that the exact relationships that had prevailed among them during the calendar year 1928 were preserved. These adjustments, which were minute in size, again illustrate the meticulous care with which the quota relationships were maintained. In 1933 the quotas of Atlantic and Purfina were increased slightly to record gains they had made against outsiders in 1932.

[13] It was proposed that imports be restricted only to existing refineries and that the erection of new refineries be prohibited; the Petroleum Times, September 8, 1934, p. 241.

[14] The "as is" group's share in the market was 65.46 percent, a figure not greatly different from those of 1928 and 1931. Purfina, which adhered to the cartel, held 8.49 percent of the trade in 1936, while the outsiders, including Texas, Sinclair, and Atlantic, held 26.05 percent of the trade.

[15] It should be noted again that such changes in the quotas are prescribed in the international agreements as a separate action, to follow after the normal and regular adjustments of over- and under-trading by compensatory sales and the exchange of customers.

[16] The sole outsider at the time the cartel was formed was Texas. The base year quotas assigned to the "as is" group totaled 60.93 percent, and those for the other three participants, 37.34 percent. These quotas were not changed by Sinclair's withdrawal in 1934 except for the striking out of its quota.

Shell—applied the "as is" principles in the asphalt and white spirit markets as well. The two companies predominated in both markets, holding about 88 percent of the asphalt market in the base year, 1928,[17] and about 80 percent of the white spirit market in 1930, when a cartel was formed. The other participant in the white spirit cartel was Deco, which held the remaining 20 percent of the trade. In 1932, however, some outside competition developed and Deco withdrew from the cartel a year later.[18] In 1936, the two "as is" companies held about the same proportions of the trade in each product as in the earlier years.

In Belgium, therefore, cartel arrangements conforming for the most part to quotas based on the "qualifying period" of the international agreements were established in all important domestic product markets. In 1931, a year when all the cartels were in full operation, the "as is" group accounted for 65.71 percent of the trade in all petroleum products covered by these cartels and by the international agreements, while other cartel adherents held 29.65 percent of the trade and outsiders only 4.64 percent. In 1936, the "as is" group accounted for 62.86 percent of the total domestic Belgian trade in these products, a decline of 3 percentage points. The share of the other cartel adherents, however, had dropped to 13.03 percent, mainly due to defections from the benzene cartel.

The record of cartel arrangements in the Netherlands is so similar to that in Belgium as to require little additional comment. Cartels were formed in 1930 in the benzene and kerosene markets, the members of both cartels being the three members of the "as is" group, and Texas, Sinclair, and Purfina. In 1931 the cartels as a whole controlled 88 percent of the trade in benzene and 95 percent in kerosene. This strong control persisted until Texas left both cartels on July 1, 1936. Cartels were also formed in the black oils and white-spirit markets,[19] at about the same times and with about the same membership as in Belgium. Standard (New Jersey) and Shell also cooperated in the asphalt market, of which they controlled 84–89 percent. The basis of the quotas in all these cartels was the "qualifying period" of 1928 prescribed in the international agreements, and all subsequent adjustments in the quotas altered the basic relationships only slightly. The "as is" companies, which had controlled nearly 75 percent of the Dutch petroleum trade in 1931, the first year of full cartel operations in all divisions of the trade, still controlled 71.65 percent in 1936. The share of the market held by other cartel members fell from 17.19 percent in 1931 to 11.49 percent in 1936, mainly due to the withdrawal of Texas from the cartels.

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[17] In 1928 Shell held 87.46 percent of the asphalt market and Standard (New Jersey), 0.12 percent. A firm known as Calol also participated in the arrangements. Standard improved its quota by the acquisition of Calol and another outsider, so that in 1935, after the quotas had been revised as a result of adjustments for over- and under-trading, its quota was 8.17 percent, and Shell's was 86.62 percent. Texas participated in the cartel arrangements in the asphalt market from August 1, 1932, to February 2, 1934.

[18] The base year (1929) quotas were: Standard (New Jersey), 26.32 percent; Shell, 53.68 percent; Deco, 20 percent. These quotas remained in effect throughout, except that Deco's was marked as an outsider's quota after 1933.

[19] The base-year quotas for the black-oils cartel members were: Standard (New Jersey), 20.86; Shell, 62.66; Anglo-Iranian, 3.68; other members (Gulf and Purfina), 11.94. Three nonmembers held 0.86 percent of the trade. These quotas were adjusted, chiefly for Gulf's benefit, in 1932 and 1936, the cartel claiming 100 percent of the trade, although 8 or more outsiders actually held 4.2 percent in 1936. The three members of the white-spirit cartel, Standard (New Jersey), Shell, and Deco, held 95.6 percent of the trade in 1929, the base year; quotas were allotted on the basis of 100 percent, however, although outsiders subsequently gained 15 percent of the trade.

Other case studies

The preceding case studies have illustrated in some detail the application of the international marketing agreements in local markets and the resultant development of local cartels. In this section less detailed studies are presented of other local cartels. The information on which these are based is taken for the most part from the Standard Oil Co. (New Jersey) documents, Deliveries into Consumption—Europe and Deliveries into Consumption—Latin America. Supplementary information has been given when available.[20]

TABLE 23.—*Deliveries into consumption of "controlled" products*[1] *in Belgium, 1931 and 1936*

[In metric tons]

Company	1931		1936	
	Tons	Percent	Tons	Percent
Standard (New Jersey)	126, 071	27. 03	140, 527	23. 08
Royal Dutch-Shell	127, 255	27. 29	176, 860	29. 05
Anglo-Iranian	53, 132	11. 39	65, 359	10. 73
Total "as is" group	306, 458	65. 71	382, 746	62. 86
Other cartel members	138, 273	29. 65	79, 366	13. 03
Total cartel	444, 731	95. 36	462, 112	75. 89
Nonmembers	21, 616	4. 64	146, 782	24. 11
Total market	466, 347	100. 00	608, 894	100. 00

[1] Includes all petroleum products sold for domestic consumption except lubricating oils and specialty products.

TABLE 24.—*Deliveries int oconsumption of "controlled" products*[1] *in the Netherlands, 1931 and 1936*[1]

[In metric tons]

Company	1931		1936	
	Tons	Percent	Tons	Percent
Standard (New Jersey)	242, 057	34. 27	282, 223	29. 47
Royal Dutch-Shell	272, 848	38. 62	385, 702	40. 28
Anglo-Iranian	14, 039	1. 99	18, 154	1. 90
Total "as is" group	528, 944	74. 88	686, 089	71. 65
Other cartel members	121, 451	17. 19	110, 051	11. 49
Total cartel	650, 395	92. 07	796, 140	83. 14
Nonmembers	56, 028	7. 93	161, 457	16. 86
Total market	706, 423	100. 00	957, 597	100. 00

[1] Includes all petroleum products sold for domestic consumption except lubricating oils and specialty products.

The Scandinavian countries.—For the most part, the available information concerning petroleum cartel activities in Denmark, Norway, and Finland is limited to reports on "as is" group affairs dur-

[20] See p. 288, footnote 49. In the case studies of Latin-American countries, summary tables are not presented because of difficulties in converting the statistics given in the Standard Oil Co. (New Jersey) documents, Deliveries into Consumption—Latin America, into a common unit. In terms of volume of sales, the most important products in most Latin-American markets are fuel oil, and gasoline in order of importance, and details are given for these two products. The names of the classes of petroleum products in Latin America, while different from those in Europe, generally denote the same range of products.

ing the period 1928–36, i. e., reports on the distribution quotas fixed and the trading results achieved by Standard (New Jersey), Shell, and Anglo-Iranian. This study, therefore, will present little more than a summary of this market information since nothing is known about the local arrangements that may have been arrived at among the "as is" members or with their competitors in pursuance of the international agreements. To round out the picture for the Scandinavian countries as a whole, certain of the data presented in the Swedish case history are repeated here.

The base year trading results achieved by the "as is" companies in the Scandinavian countries are shown in table 25, which lumps together the trading results achieved in each domestic product market, except for lubricating oils and specialty products. It will be seen that the "as is" group together held the following percentage positions: Denmark, 91.6 percent; Finland, 96.1 percent; Norway, 97.8 percent; and Sweden, 81.9 percent. While the distribution quotas were fixed separately in each product market, the "as is" companies practically preempted the entire market during this "qualifying period"—a position which was to be reflected in the distribution quotas.

TABLE 25.—*Deliveries into consumption of controlled products in the Scandinavian countries in the base year, 1928*

[In metric tons]

Company	Denmark	Finland	Norway [2]	Sweden
Standard Oil Co. (New Jersey)	199, 467	53, 789	77, 899	145, 545
Royal Dutch-Shell group	69, 306	49, 175	47, 966	150, 399
Anglo-Iranian Oil Co.	56, 000		37, 003	4, 539
Total "as is" group	324, 773	101, 964	162, 868	300, 483
All others	30, 592	4, 113	3, 645	51, 084
Total market	355, 365	106, 077	166, 513	351, 567

[1] Includes all petroleum products sold for domestic consumption except lubricating oils and specialty products.
[2] Companies' own use excluded, except for "black oils." Large contracts for "black oil" also excluded.

The distribution quotas that were fixed from time to time in the Scandinavian benzine markets are reproduced in table 26.[21] These are representative of the quotas fixed in the other product markets.

The "1928 basic" quotas reflect the relative positions of the "as is" companies during the "qualifying period." The meticulous care with which the rights of the parties were safeguarded is shown in the revisions of the base year data for Norway, each revision adjusting the quotas by only a few hundredths of a percentage point.[22] Similarly, the benzine quotas for Denmark were revised by a few hundredths of a percentage point, effective January 1, 1931, to reflect adjustments in the quotas due to "over- and under-trading."[23] This kind of quota revision was prescribed in the Memorandum for European Markets,[24]

[21] These are taken from Deliveries Into Consumption—Europe, except for the Swedish quotas effective Octobr 10, 1937, which are taken from the report of the Oil Investigating Committee of 1945; see p. 300.

[22] It is not clear why the basic quotas were revised for each product market, except "black oils," effective January 1, 1935, so as to exclude "own use." Trading results were similarly adjusted. Since this was not done in any other country, it probably reflects some special settlement of the quotas by the local managements.

[23] The distribution quotas for kerosene in Denmark were similarly revised, effective January 1, 1932.

[24] Similar provisions were included in the Draft Memorandum of Principles.

which was then in effect, as a sequel to the regular market adjustments of over- and under-trading through the transfer of customers or the making of compensatory sales.

TABLE 26.—*Benzene quotas in Denmark, Finland, and Norway, 1928–36*

	Standard (New Jersey)	Shell	AIOC	Others
Denmark:				
1928 basic	44.89	31.99	18.44	4.68
Effective Jan. 1, 1931, adjusted for over- and under-trading	44.82	32.06	18.44	4.68
Effective Jan. 1, 1936, adjusted for unobtainable	39.97	28.59	16.44	15.00
Effective Jan. 4, 1936, adjusted for revised unobtainable	38.79	27.75	15.96	17.50
Finland:				
1928 basic	49.126	46.872		4.002
Effective Jan. 1, 1936	40.000	40.000		20.000
Norway:				
1928 original; own use included	43.33	33.14	22.92	.61
1928 revised; after audit	43.37	33.11	22.91	.61
Effective Jan. 1, 1935; 1928, own use excluded	43.39	33.13	22.87	.61
Effective Jan. 1, 1936	39.29	30.00	20.71	10.00
Sweden:				
1928 basic	37.03	42.94	1.94	18.09
Effective Jan. 1, 1936	28.06	32.53	8.43	30.98
Effective Jan. 10, 1937 [1]	28.06	32.53	8.43	5.97

[1] Distribution quotas effective on this date also included: Texas, 12.92 percent, and Gulf, 12.09 percent; see table 14, p. 298.

In each of the four countries, substantial downward revisions of the distribution quotas, effective January 1, 1936, were made to account for what was "unobtainable," as is noted in the Danish quotas.[25] These quota adjustments, which were made for nearly all product markets, recognized the permanently reduced *percentage* positions of the "as is" parties from those of 1928.

The trading results in the Scandinavian markets in 1936 are summarized in table 27. The "as is" companies in that year held the fol-

TABLE 27.—*Deliveries into consumption of controlled products [1] in Scandinavian countries in 1936*

[In metric tons]

Company	Denmark	Finland	Norway [4]	Sweden
Standard Oil Co. (New Jersey)	267,433	60,550	115,298	226,090
Royal Dutch-Shell group	120,467	72,586	87,019	270,505
Anglo-Iranian Oil Co., Ltd	78,645		70,726	52,519
Total "as is" group	466,545	133,136	273,043	549,114
The Texas Co				72,478
Russian Export Trust	7,206	18,786	15,540	67,467
Gulf Oil Corp.[2]	61,200			26,259
A. Johnson & Co.[3]	3,014	95		30,371
All others	77,276	17,499	23,020	31,894
Total market	615,241	169,516	311,603	777,583

[1] Includes all petroleum products sold for domestic consumption except lubricating oils and specialty products.
[2] Alfred Olson & Co., an affiliate. (See p. 334, footnote 31.)
[3] Parent corporation of Nynas Petroleum Co., Sweden.
[4] "Own use" of the companies excluded; large contracts in the "black oils"—(fuel, Diesel, and gas oils—excluded.

[25] The revised quotas were generally somewhat higher than the percentage positions that were actually held in 1935. The quotas in Finland provided for an equal division of the obtainable markets between Shell and Jersey Standard, although the latter had held a better position in Finnish markets than Shell during the base year. This probably compensated Standard for the fact that after the early 1930's its percentage share in each product market was lower than Shell's.

lowing combined share in these markets: Denmark, 76.13 percent; Finland, 78.54 percent; Norway, 87.63 percent; and Sweden, 70.62 percent. These proportions were 12 to 18 percent lower than those held in 1928, and reflect the circumstances that had led to the revision of the distribution quotas. Nevertheless, since Scandinavian markets had expanded strongly since 1928, the "as is" companies enjoyed large increases in the volume of sales over those of the base year.[26]

The most important outsider in the Scandinavian markets was the Russian Export Trust, which had established marketing organizations in the four countries in the late 1920's and had rapidly expanded its operations. The peak years of Russian penetration in the market were 1933 and 1934,[27] with subsequent decline, particularly in Denmark.[28] Thus, the shares of the markets attributed to the Russians in table 27 represent the achievement of a declining competitor.

Early in 1937, Gulf Oil Corp. purchased the Russian marketing organizations in Denmark, Finland, and Sweden, operating through its affiliate, Alfred Olson & Co.[29] During the period 1928–36, the latter firm had acquired a substantial business in fuel, gas, and Diesel oils in Sweden,[30] and had held 30 to 35 percent of the trade in these products in Denmark. These interests and the newly acquired Russian organization were brought together in a single structure headed by Alfred Olson, who became manager of all of Gulf's Scandinavian operations.[31]

The other firms in the Scandinavian petroleum markets were generally of minor significance, holding in most cases small fractions of the market.[32]

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[26] The sales volume (in metric tons) of the "as is" companies was 44 percent greater in Denmark in 1936 than it had been in 1928; 31 percent greater in Finland; 68 percent greater in Norway; and 83 percent in Sweden. The over-all Scandinavian increase was 60 percent.

[27] The Russians held 20.34 percent of the Danish and 21.89 percent of the Finnish benzene markets in 1933, and 7.08 percent of the Norwegian market in 1934. Their share of kerosene markets was 10.97 percent in Denmark and 5.20 percent in Norway in 1934, and 15.19 percent in Finland in 1932. In "black oils," the Russians held 27.34 percent of the Finnish market and 12.98 percent of the Norwegian market in 1934. After attaining these peak positions in the markets in which they were interested, the Russian percentage shares rapidly declined to the levels of 1936.

[28] In Denmark, the Russians almost literally dropped out of the market in 1936, having total sales of 7,206 metric tons in 1936, as compared with sales of 48,927 tons in 1934 and 41,697 tons in 1935.

[29] While not mentioned in the press reports, the Russian marketing organization in Norway probably was included in the sale. Among the terms of the transaction, the following was reported: "The supply agreements which the corporation's [Gulf's] British, Belgian, and Scandinavian subsidiary companies have with Soyougnefteexport were also renewed." The Petroleum Times, May 29, 1937, p. 716, and November 13, 1937, p. 645.

[30] See table 15, p. 302.

[31] It is not clear precisely what relation the Olson firm had to Gulf prior to 1937; hence it is referred to above as an "affiliate." The Report of the Swedish Oil Investigating Committee of 1945, chs. II and XIV, states that the Olson firm and the Swedish Gulf Oil Co. were wholly owned by Gulf in 1947. It may be recalled that after the reorganization of its Scandinavian interests, Gulf's Swedish interests entered in full participation in the Swedish "as is" agreement of 1937, and that prior to that agreement there had been cooperation between Gulf interests and the Swedish cartel.

[32] The shares of the market held by firms other than the "as is" group, the Russians, and Gulf were as follows:

In Denmark six firms together held 3.66 percent (22,552 metric tons) of the total petroleum market in 1936, practically all of this in the asphalt and road-oil market. One of these firms, A. Johnson & Co. (parent of the Swedish concern, Nynas), participated in the "as is" arrangements in the asphalt market, being given a quota of 13 percent. In addition to these, "sundry" other competitors held 9.42 percent (57,738 metric tons) of the market. This "sundry" group, which had never before held more than 0.5 to 1.5 percent of the market, was probably this large because of the spot market for benzene and kerosene created when the Russians practically quit the market in that year.

In Finland the principal other competitor was a Hamburg firm, known as Eurotank, which held 7.56 percent of the total market in 1936. Six other firms and the "sundry" competitors together held 2.82 percent.

In Norway a subsidiary of the Sinclair Oil Corp. held 4.32 percent of the total trade and three other firms and the "sundry" competitors together held 3.07 percent.

The other competitors in Sweden were discussed in the case study of that country.

In summary, therefore, three international oil companies—Standard (New Jersey), Shell, and Anglo-Iranian—were the principal marketers of petroleum products in the four Scandinavian countries. In each of these countries they cooperated among themselves in the local application of the marketing principles set forth in the international agreements they had arrived at. In Sweden other firms, representing nearly all of the outside trade, were participants or cooperators in the local cartel arrangements.

In 1937 the principal outside firms, the subsidiaries of the Russian Export Trust and affiliates of Gulf, were merged into a unified organization controlled by Gulf. The Swedish subsidiary of this organization, wholly owned by Gulf, soon thereafter became a full participant in the Swedish cartel. The Gulf organization, the "as is" group, and the other participants in the Swedish cartel, the Texas Co. and A. Johnson & Co. (Nynas) constituted nearly all of the Scandinavian oil trade.

Argentina.—The application of the "as is" principles in Argentina by Standard (New Jersey) and Shell was complicated by the existence of the State Oil Fields Department (YPF)[33] which conducted fully integrated petroleum operations from the oil fields to the market. Until 1936 YPF and the smaller distributors in the market increased their control of the profitable gasoline market, while the "as is" group increased their share in the larger market for the less valuable product, fuel oil.[34]

Distribution quotas in Argentina were fixed up to 1937 by the major international companies in accordance with the "as is" principles, on the basis of the shares of the market actually held during the "qualifying period," 1928. The shares of the various product markets to which Standard (New Jersey) and Shell were "entitled" are shown in the top section of table 28, which also shows the established positions of YPF and the independent companies in 1928. The distribution quotas were subject to a general revision, effective January 1, 1936, which recorded the great changes that had taken place in the market.[35] These revised quotas are shown in the middle portion of table 28. Finally, the shares of the various product markets actually held by the different companies in 1936 are shown in the bottom of table 28. The most important changes were in the gasoline market, where the "as is" group lost ground, and in the fuel-oil market, where the group made substantial gains.[36]

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[33] Yacimientos Petroliferos Fiscales.

[34] Fuel oil was quantitatively the most important market in most Latin-American countries, and gasoline was second.

[35] Jersey Standard's quotas were revised upward, effective January 1, 1932, when it acquired, through the purchase of Pan American, Standard of Indiana's Argentine interests. The gasoline quotas were also revised, effective January 1, 1933, to record YPF's gains to that date.

[36] In 1936, sales in the total gasoline market were 6.3 million barrels, an increase of 47.4 percent over 1928. In the fuel-oil market, 1936 sales of 1.4 million metric tons were 15.9 percent higher than in 1928. The percentages given in table 28 indicate the shares of the various marketers in these markets. Fuel oil accounted for more than 50 percent of Argentina's total consumption of petroleum, while gasoline accounted for about 25 percent. See Petroleum Times, March 5, 1938, p. 307.

TABLE 28.—*Deliveries into consumption of petroleum products and distribution quotas in Argentina, 1928 and 1936* [1]

[Expressed in percentages]

	Standard (New Jersey)	Shell	YPF [2]	Others	Total
1928—Base year quotas (trading results):					
Gasoline	45.79	27.65	14.63	11.93	100
Refined oil [3]	43.92	16.91	22.08	17.09	100
Fuel oil	3.61	28.76	31.43	36.20	100
Gas and Diesel oil	44.34	20.47	2.68	32.51	100
Asphalt and road oil	11.74	76.05		12.21	100
1936—Distribution quotas:					
Gasoline	33.91	20.67	(28.00)	17.42	100
Refined oil [3]	37.24	14.10	48.66		100
Fuel oil	6.20	40.77	53.03		100
Gas and Diesel oil	44.13	19.47	36.40		100
Automotive gas and Diesel oil	33.91	20.67	(28.00)	17.42	100
Asphalt and road oil	23.92	53.35	22.73		100
1936—Trading results:					
Gasoline	30.51	22.01	28.98	18.60	100
Refined oil [3]	32.23	18.62	29.16	19.99	100
Fuel oil	8.06	39.45	29.51	22.98	100
Gas and Diesel oil	36.04	25.83	20.32	17.81	100
Automotive gas and Diesel oil	58.41	16.11	8.25	17.23	100
Asphalt and road oil	24.37	52.30	16.76	6.57	100

[1] Including Paraguay, whose consumption is a negligible proportion of the whole.
[2] Yacimiento Petrolíferos Fiscales.
[3] Kerosene, tractor fuel, and similar products.

In 1936 the Argentine Government initiated new petroleum policies which put YPF in a favored position. The State Oilfields Department (YPF) was given regulatory powers over imports, including the power to apportion imports among all the companies, including itself. Importing companies were required to arrive at agreements with YPF before they could be entered on the register of importers. Exports of petroleum were forbidden.[37]

In its negotiations with Standard (New Jersey) and Shell under this law, YPF attempted to reserve the bulk of the concentrated and highly profitable Buenos Aires gasoline market for itself.[37] The result of these discussions was an agreement for the gasoline market which was to run for 3½ years, beginning July 1, 1937.[38] This agreement covered 100 percent of the market, since YPF represented also the smaller concerns, with which it had previously come to terms. The quota arrangements were based on an assumed market of 6,065,025 barrels. The apportionment of this market is shown in table 29. It was agreed that YPF would have "preferential treatment," i. e., a prior right, in all consumption in excess of 6,065,025 barrels. Since consumption in 1936 was more than 6.3 million barrels,[39] this meant that YPF was to have all the normal increase in consumption occurring after 1936. Other provisions of the agreement which, since YPF represented all small marketers, governed the entire trade, included the fixing of prices at uniform levels and the creation of a tribunal to administer the agreement.

[37] Ibid., January 15, 1938, p. 88.
[38] Ibid., October 16, 1937, p. 494.
[39] In 1935 consumption was 5.97 million barrels, so that most of the 1936 increase was also reserved to YPF. These figures are converted to 42-gallon barrels from data given in 50-gallon barrels in Deliveries Into Consumption, Latin America.

TABLE 29.—*Gasoline quotas under the Argentine Agreement of 1937*

[In 42-gallon barrels]

	Estimated total market		Estimated Buenos Aires market		Estimated other Argentine market	
	Barrels	Percent	Barrels	Percent	Barrels	Percent
Standard (New Jersey)	1,807,281	29.80	451,577	23.95	1,355,704	32.44
Royal Dutch-Shell	1,284,466	21.18	241,156	12.79	1,043,310	24.96
Y. P. F.[1]	2,973,277	49.02	1,192,767	63.26	1,780,510	42.60
Total	6,065,024	100.00	1,885,500	100.00	4,179,524	100.00

[1] Yacimientos Petroliferos Fiscales. Y. P. F.'s quotas include those of the other firms operating in Argentina.

Source: The Petroleum Times, Oct. 16, 1937, p. 494.

Chile.[40]—In Chile the principal distributors in 1928 were Standard (New Jersey) and Shell. The two international companies held substantial control of all markets, except that their shares of the "black oils" markets were low because the principal consumers, the mining companies of northern Chile, were direct importers. The share of the 1928 markets held by the "as is" group, and hence the base-year quotas, were:

	Standard (New Jersey)	Shell
Gasoline	61.45	37.30
Refined oil	58.50	38.63
Fuel oil	31.59	8.23
Gas and Diesel oil	44.86	2.82
Asphalt and road oil	3.04	55.07

These quotas were for the most part unchanged until January 1, 1936, when general revisions were made to record the "as is" group's control of 100 percent of the small asphalt market and their losses in the gasoline and refined-oil markets.[41] These losses were occasioned by the entry in the Chilean market of a new firm known as Copec.[42] In 1936 this firm held 20.98 percent of the gasoline market and 1.87 percent of the kerosene market.

A cartel was formed with Copec, with relative distribution quotas effective January 2, 1937. The two international oil companies secured a gasoline quota of 66.67 percent, which they divided as follows—Standard (New Jersey), 41.77 percent, and Shell, 24.90 percent. Copec's gasoline quota was 33.33 percent. In the kerosene market, Copec obtained a quota of 10 percent and the "as is" group 90 percent, divided as follows—Standard (New Jersey), 54.21 percent and Shell, 35.79 percent.[43]

[40] Information in this section on Chile is taken from Deliveries Into Consumption—Latin America.

[41] The quotas were reduced proportionately so that the two companies had the same ratio relationship as in 1928. There were no quota changes in the fuel and gas/Diesel oil markets.

[42] Compania de Petroleos de Chile, a privately owned company. This company is reported to have had strong support from the Chilean Government after it was founded in 1934. Hearings on the Foreign Contract Act, op. cit., p. 157.

[43] Both the gasolene and the kerosene quotas were divided in this way so as to preserve the 1928 ratio between Standard and Shell.

In postwar editions of the International Petroleum Register, the following note appears:[44]

The import and distribution of the principal petroleum products, with the exception of the fuel oil for the mining companies in the North, is operated today by three companies, the Copec (Compania de Petroleos de Chile), the Esso Standard Oil Co., Chile, and Shell Mex Co., Chile. Each company has a quota of about one-third, with increases in some cases until 50 percent for the Copec.

Brazil.[45]—The principal marketers in Brazil during the 1930's were subsidiaries of Standard (New Jersey), Shell, Atlantic Refining Co., and Texas Co. Other sales were almost entirely by Pan American, a subsidiary of Standard of Indiana, whose interests were acquired by Jersey Standard in 1932. The shares of these companies in the various markets in 1928 were as follows:

	Standard (New Jersey)	Shell	Atlantic	Texas	Other
Gasoline	47.40	20.40	17.56	13.20	1.44
Refined oil	49.11	18.01	12.04	16.72	4.12
Fuel oil	4.54	50.88			44.58
Gas and Diesel oil	5.87	36.71	2.32		55.10
Asphalt and road oil	30.23	12.49			57.28

The quotas of Standard (New Jersey) and Shell were based on 1928 shares in the market, except for increases in Standard's quotas due to the acquisition of Pan American in 1932. These quotas were replaced in 1934 and 1935 by other arrangements.[46]

In 1934, Standard (New Jersey) and Shell formed a "black oils pool."[47] It was agreed that they would divide the fuel-oil market, of which they then controlled 100 percent, on a 50–50 basis,[48] and the gas and Diesel oil market, of which they then controlled 94 percent, on a basis of 52.5 percent for Standard and 47.5 percent for Shell.[49]

In the following year, Standard (New Jersey), Shell, Texas, and Atlantic formed a "white oil cartel" for the gasoline and refined oils markets. The quotas that were established, effective January 1, 1934, were as follows:

	Gasoline	Refined oils
Standard (New Jersey)	43.32	43.97
Shell	18.61	17.26
Atlantic	20.73	15.56
Texas	16.32	18.21
Others	1.02	5.00

These quotas closely reflect the actual marketing positions of the companies in 1934–35 and are not greatly different from their trading positions in 1928.

[44] P. 481 in the 1949 edition.
[45] Information in this section on Brazil is taken from Deliveries Into Consumption—Latin America.
[46] Except in the asphalt market, which continued substantially under the base-year quotas until 1936, when quotas of 62.05 percent for Standard and 13.63 percent for Shell were fixed. In 1936 most of the remaining competition left the market.
[47] Bunker oils were included in this pool.
[48] Actually the relation of Standard to Shell in the market in 1934 and after was closer to 60–40. Presumably adjustments were made as a result of this over- and under-trade situation.
[49] The outsiders, chiefly Atlantic and Texas, increased their share of the market to about 12 percent in 1936.

Mexico.[50]—The four principal marketers in Mexico—Standard (New Jersey), Shell, Sinclair, and Standard Oil Co. of California—formed cartels in Mexico in 1933 covering all petroleum products except the minor specialty products. It was agreed that relative distribution quotas were to be fixed, based on the combined sales of the four companies. Since, for the most part, outsiders were of negligible importance in the market,[51] these quotas were substantially divisions of the whole market. The relative quotas, effective January 1, 1933, were as follows:[52]

	Standard (New Jersey)	Shell	Sinclair	Standard (California)
Gasoline	24.854	35.380	20.880	18.886
Kerosine	27.238	38.168	30.181	4.413
Tractor fuel	21.126	47.980	24,207	6.687
Diesel fuel oil	13.750	31.198	15.746	39.306
Commercial fuel oil	25.419	47.649	12.632	14.300
Railroad fuel oil	53.710	46.290	-----	-----
Commercial lubricating oil	31.080	36.097	25.853	6.970
Railroad lubricating oil	50.000	25.000	25.000	-----
Greases	14.948	43.700	36.270	5.012

These quotas generally accorded with market positions held by the four participants in 1930, the first year for which market statistics are given in the documents, Deliveries Into Consumption—Latin America. For the most part these quotas were adhered to in the market, although there was substantial over- and under-trading in some cases.[53] There was a general revision of the quotas, effective January 1, 1936, but there were few changes of more than 1 or 2 percentage points, most of the adjustments occurring in the quotas of Sinclair and Standard of California.

Cuba.[54]—In accordance with the "as is" principles, Standard (New Jersey) and Shell fixed distribution quotas for the Cuban market on the basis of their positions in 1928. The shares of the market held by the two "as is" companies, and hence their distribution quotas, were as follows:

	Standard (New Jersey)	Shell	Others
Gasoline	50.31	22.54	27.15
Refined oil	96.33	-----	3.67
Fuel oil	18.43	17.20	64.37
Gas and Diesel oil	97.61	-----	2.39
Asphalt and road oil	90.43	4.01	5.56

[50] Information in this section is taken from Deliveries Into Consumption—Latin America. Jersey Standard became an important factor in Mexico in 1932 through the acquisition of the Mexican properties of Standard of Indiana in the purchase of the foreign properties of its subsidiary, Pan American Petroleum & Transport Co.

[51] Outsiders, in the 7-year period, 1930–36, held at most 3 to 4 percent of each market, except in the case of the minor products, commercial lubricating oils and greases, of which, in some years, they supplied 13 to 15 percent.

[52] These quotas applied to combined sales up to fixed maximums—e. g., 1,810,000 barrels in the case of gasoline and 8,500,000 barrels in the case of commercial and railroad fuel oils combined. Combined sales above these maximums were to be divided four ways, each participant to have 25 percent. These set maximums were eliminated in the general revision of quotas in 1936.

[53] It is not known what devices were used to enforce compliance with the quotas. In some cases, the overtrading was by agreement, as in the railroad lubricating oil market where Standard (New Jersey) held 100 percent of the trade. In the case of commercial lubricating oils, where outsiders held 7–14 percent of the trade, it was expressly stated that the quotas could be exceeded at the expense of outsiders—a basic "as is" principle.

[54] Information in this section is taken from Deliveries Into Consumption—Latin America.

These quotas were retained without substantial change until revised quotas went into force, effective January 1, 1936, which recorded the small changes that had taken place in the market.

The principal "outsider" in the Cuban market was the Sinclair Oil Corp., which accounted for most of the business of the "other" marketers. Beginning in 1932, Standard (New Jersey) and Sinclair entered into a supply relationship. By 1935 Standard supplied all of Sinclair's requirements of fuel oil, kerosene, and gas and Diesel oil for the Cuban market.

The "as is" companies and Sinclair formed a cartel for the most important petroleum products, the distribution quotas effective January 1, 1937, being:

	Standard (New Jersey)	Shell	Sinclair	Other
Gasoline	42.13	19.85	27.10	10.92
Refined oil	92.35		4.90	2.75
Gas and Diesel oil	81.98		4.64	13.38
Asphalt and road oil	70.09	2.88	24.31	2.72

No quotas were fixed for fuel oil. It was stated that the cartel arrangement in this market was based on a "gentleman's agreement" with Sinclair. The quotas reflect rather closely the market situation current in the mid-1930's except in the refined oil market, where Standard had lost a substantial part of its business to outsiders. There Standard was recognized as "entitled" to 92.35 percent of the trade, although its actual share of the market in 1935 was only slightly over 50 percent. This quota, therefore, was in line with the usual "as is" practice of retaining in principle the 1928 historic position except when adjustments are dictated by cartel operations.

The Lesser Antilles.[55]—The international oil companies extended their cartel arrangements to some of the smallest markets of Latin America. The markets of the islands of the Lesser Antilles in the Caribbean Sea are individually small and collectively of minor importance; nevertheless, cartels were formed under "as is" principles in the islands of Barbados, Jamaica, Trinidad, and the Windward and Leeward Islands, and in the Guiana territories of the northern shore of South America. The principal participants in these cartels were the marketing subsidiaries of Standard (New Jersey), Shell, and Trinidad Leaseholds, Ltd. (TLL), the latter two companies operating most frequently as a pool.[56]

Cartel arrangements were made in the gasoline, refined oil (including tractor fuel), fuel oil, gas and Diesel oil, asphalt and road oil, lubricating oils, and grease markets. In each market, quotas based on the "qualifying period," 1928, were fixed for each of the parties, the cartel participants generally controlling all or nearly all of the market. The quotas were subject to the pattern of minor adjustments

[55] Information in this section is taken from Deliveries Into Consumption—Latin America.

[56] Other cartel participants of lesser importance included the Texas Co. (until 1935, when it withdrew from all cartel arrangements in this area), Trinidad Central Oilfields, Ltd. (TCO), and British Union (sic). These firms were not in all markets. TCO was supplied by organizations that appear to have been subsidiaries or affiliates of the principal cartel members.

and general revisions in 1936 that was typical of all "as is" quota operations.[57] Table 30 shows the base-year quotas in these markets for gasoline, which were fairly typical of the quotas for other products, except that the market for gasoline tended to be divided among more participants than was usually the case. The smallness of these markets is indicated by the fact that the total combined sales for 1936 in the five marketing areas amounted to only 450,000 barrels. This was about 40 percent of the sales in the Cuban market of that year and about 15 percent of that in Brazil, both of which were in turn minor markets.

TABLE 30.—*Gasoline distribution quotas in the Lesser Antilles and Guiana*[1]

	Standard (New Jersey)	Shell	TLL[2]	Pool[3]	Other cartel[4]	Others
Barbados	11.88			84.06	3.79	0.27
Guianas group[5]	30.18			62.70	[7] 7.12	
Jamaica	7.86	45.47	30.46		16.21	
Trinidad	7.19	39.83	39.83		[7] 13.15	
Windward and Leeward Islands[6]	20.84			57.73		16.43

[1] As determined by marketing results during the "base year," 1928.
[2] Trinidad Leaseholds, Ltd.
[3] The "Pool" included the combined quotas of Shell and TLL.
[4] In Barbados, the Guianas group, and Trinidad, the other cartel member was Trinidad Central Oilfields, Ltd., and in Jamaica, the Texas Co.
[5] Including Surinam, French and British Guiana.
[6] Excluding Barbados, the Virgin Islands of the United States, and the Dutch West Indies.
[7] These quotas represent the combined quotas of other cartel members and of "others"; i. e., outsiders.

Other countries.—The case studies given in this chapter by no means exhaust the list of countries in which local cartels have been organized under the international marketing agreements. The Standard Oil Co. documents (Deliveries Into Consumption—Europe, and Deliveries Into Consumption—Latin America) present statistical data on the operations of the "as is" group of companies in a number of other countries of Western Europe and Latin America. Tables summarizing this information are presented at the close of this section.

The fact that the documents available to the Federal Trade Commission did not present statistics on marketing and distribution quotas in other parts of the world does not indicate that the international marketing agreements were not applied there. In the Middle and Far East, for example—the area known to the international oil companies as "east of Suez"—there are a great many indications that the international oil companies agreed upon cartel arrangements governing the market positions each had established.

As was shown in the first part of chapter VIII, the beginning of cooperation of the major international oil companies in the Indian market in the mid-1920's, and the resulting division of that market among them, led directly to the conclusion of the Achnacarry or "as is" agreement of 1928. In these earlier years in the Far East, moreover, there are numerous indications of close cooperation among the

[57] An interesting quota adjustment was made in 1934 when TLL accepted a lower gasoline quota in Trinidad and was granted a higher refined oil quota in Jamaica. Such transactions may have been useful devices for settling various problems that might arise between the parties.

international oil companies. For example, it was reported in the Petroleum Times [58] that the Chinese market had been controlled since 1914 by Dutch and American oil companies (chiefly Shell and Standard Oil Co. of New York). These companies had reached agreements which "regularized the market" and maintained uniform prices since that time. P. W. Parker, in a Standard-Vacuum memorandum of January 7, 1935, dealing with tax difficulties of 1934–35 with the Chinese Government, stated that the cartel arrangements in China were on an "as is" basis.[59] It was reported officially in 1931 that prices in local markets in the Dutch East Indies were much too high in comparison with those in other producing countries due to a price agreement between Shell and Standard (New York).[60] In Japan, Shell and Standard (New York) had been the dominant forces in the market since 1906. In 1931, as a result of price cutting by domestic firms, the two international oil companies made a "new agreement" with the four leading domestic firms—Nippon Oil, Ogura, Mitsubishi, and Mitsui. This agreement was "designed to regulate not only prices but also the quantity to be marketed." Prices immediately rose as a result of this cartel arrangement.[61]

This cooperation, moreover, appears to have continued until recent years. In chapter V light is thrown on this in the discussion of the problems of marketing Bahrein and Aramco oil. Thus it appears that Standard of California could not dispose of its oil until it was able, through the merger of its Middle East producing interests with Far East marketing subsidiaries of the Texas Co., to funnel its oil into a distributing organization which held established positions in Far East markets.[62] The cartel restrictions on these joint marketing organizations, moreover, limited the amount of Bahrein and Aramco oil that could be disposed of in these areas.[63] Similarly, the Gulf-Anglo-Iranian joint ownership agreement of 1933 (Kuwait)[64] and the contracts for the sale of crude oil dealing with Middle East oil in the postwar period,[65] all laid important restrictions on the movement of oil into the markets "east of Suez."

While it seems evident that cooperation existed among the oil companies in the markets east of Suez, no information is available that would indicate the nature of the agreements governing this cooperation. The fact that the Standard Oil Co. documents are limited in their coverage to Europe and Latin America, therefore, does not signify that "as is" or other cartel arrangements were not applied in those areas.

In central and southeastern Europe and the eastern Mediterranean, cooperation among the international oil companies with regard to distribution was complicated by difficulties in regulating oil production

[58] December 27, 1930, p. 1039.
[59] Patents, hearings, pt. 7, p. 3691.
[60] The Petroleum Times, January 23, 1932, p. 98.
[61] Ibid., May 16, 1936, p. 629.
[62] See pp. 114–116.
[63] See pp. 118–119.
[64] See p. 132.
[65] See pp. 140–141 and 157.

in Rumania. This country supplied crude oil and refined products to its own domestic markets and was a principal supplier to markets in this area.[66] As has been previously shown, the international oil companies, which were themselves important petroleum producers and refiners in Rumania, attempted to solve the problems occasioned by over-production in that country by creating a domestic cartel, by allocating production quotas, by determining export quotas by countries, and by purchasing excess production, thus channeling it into the hands of companies interested in maintaining the international "as is" principles.[67]

The solutions proposed for the marketing area served by Rumanian oil were specially designed to meet the special problems in that area occasioned by the breakdown of controls over Rumanian production. As such they were supplementary to, rather than in conflict with, the international "as is" principles. In many of the countries in this area, moreover, governmental economic policies were such as to make the terms of the "as is" principles inapplicable to local markets.[68] These governmental measures—tariffs, quotas, and other import controls, clearing arrangements and other financial and currency controls, special trade agreements and the like—were adopted earlier and in greater variety in these countries than elsewhere in an effort to protect and stabilize the truncated economies of these countries.[69]

The following tables present statistical information drawn from the Jersey Standard documents previously mentioned together with explanatory notes taken from the same source. These tables indicate the quotas and marketing results of the "as is" group of companies for the principal petroleum products of each country, but do not necessarily show all cartel participants due to the fact that the documents from which the information is taken are directed at setting forth the "as is" group market relationships.

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[66] Rumania alone consumed nearly as much crude oil and refined products as all other countries of central and southeastern Europe combined. In 1937–39, Rumania supplied the bulk of the crude and refined petroleum imports of Czechoslovakia, Hungary, Yugoslavia, Bulgaria, and Greece and supplied significant proportions of imports of Turkey and other eastern Mediterranean countries; see import data by countries in International Petroleum Trade, 1939 and 1940 issues.

[67] See above, pp. 236–239 and 249–251.

[68] These two factors—the adoption of special private arrangements and the economic policies of the governments—probably account for the fact that the Standard (New Jersey) documents, Deliveries into Consumption—Europe, do not include data about quotas and trading results for the countries in the area under discussion, except for data about the asphalt market in some countries.

[69] Cf. information by countries in (*a*) the annual issues of Economic Review of Foreign Countries, U. S. Department of Commerce, 1933–39, and (*b*) Regulation of Imports by Executive Action in Countries With Independent Tariff Jurisdiction, U. S. Tariff Commission, 1941. Gottfried Haberler has made an excellent survey and analysis of such governmental controls in Quantitative Trade Controls, League of Nations, 1943.

The effect of all these controls was generally to freeze and stabilize the proportions of import trade at the historic position of the participating firms attained during a "base year"—most often 1931 or 1932. Under these circumstances, the application of "as is" principles in the petroleum trade might well have been neither necessary nor relevant. For example, in Czechoslovakia and Hungary, where existing refining capacity was in excess of domestic needs, cartels were sponsored by the government in which the position of the established importers and refiners was "recognized" and preserved in quota arrangements. A similar cartel was formed in Turkey (Joint Hearings on the Foreign Contracts Act, Committee on the Judiciary and Special Committee Investigating Petroleum Resources, U. S. Senate, 1945, pp. 154–155). A discussion of controls over Rumanian production and distribution is given on pp. 236–239. All such cartels and any other such arrangement could be substituted for the "as is" arrangements by unanimous consent of the participants under the provisions of the Draft Memorandum of Principles.

TABLE 31.—*Distribution quotas and trading results for specified products in selected countries*

[Expressed in percentages]

	Base year quotas (trading results in 1928)	Quotas effective Jan. 1, 1936	Trading results, 1936
Algeria: [1]			
Benzene:			
Standard (New Jersey)	42.18	40.32	30.35
Shell	21.92	23.69	25.31
Cipan (Socony-Vacuum)	10.37	10.46	9.39
Total "as is" group	74.47	74.47	65.05
Other marketers	25.53	25.53	34.95
Total market	100.00	100.00	100.00
Kerosene:			
Standard (New Jersey)	38.28	35.13	28.05
Shell	21.07	24.69	29.05
Cipan (Socony-Vacuum)	13.31	12.84	10.80
Total "as is" group	72.66	72.66	67.90
Other marketers	27.34	27.34	32.10
Total market	100.00	100.00	100.00
Tunisia: [1]			
Benzene:			
Standard (New Jersey)	51.72	44.38	45.47
Shell	35.84	31.08	32.02
Cipan (Socony-Vacuum)	12.44	10.69	9.11
Total "as is" group	100.00	86.15	86.60
Steaua Francaise	----------	13.85	13.40
Other marketers	----------	----------	----------
Total market	100.00	100.00	100.00
Kerosene:			
Standard (New Jersey)	46.16	41.75	40.84
Shell	34.96	31.73	32.13
Cipan (Socony-Vacuum)	18.88	17.10	16.56
Total "as is" group	100.00	90.58	89.53
Steaua Francaise	----------	9.42	10.33
Other marketeers	----------	----------	.14
Total market	100.00	100.00	100.00
Switzerland: [2]			
Benzene:			
Standard (New Jersey)	35.82	35.82	29.14
Shell	33.58	33.58	27.41
AIOC	13.16	13.16	15.29
Total "as is" group	82.56	82.56	71.84
Other marketers	17.44	17.44	28.16
Total market	100.00	100.00	100.00
Black oils:			
Standard (New Jersey)	43.05	36.17	34.12
Shell	31.01	31.01	28.88
AIOC	3.12	10.00	10.22
Total "as is" group	77.18	77.18	73.22
Other marketers	22.82	22.82	26.78
Total market	100.00	100.00	100.00
Italy and Libya: [3]			
Benzene and white spirit:			
Standard (New Jersey)	44.42	45.47	28.07
Shell	27.37	28.01	26.10
AIOC	1.79	.10	.08
Total "as is" group	73.58	73.58	54.25
Other marketers	26.42	26.42	45.75
Total market	100.00	100.00	100.00

See footnotes at end of table.

TABLE 31.—*Distribution quatas and trading results for specified products in selected countries*—Continued

[Expressed in percentages]

	Base year quotas (trading results in 1928)	Quotas effective Jan. 1, 1936	Trading results, 1936
Italy and Libya—Continued			
Black oils:			
Standard (New Jersey)	28.77	33.41	20.80
Shell	23.31	27.07	23.66
AIOC	8.40		
Total "as is" group	60.48	60.48	44.46
Other marketers	39.52	39.52	55.54
Total market	100.00	100.00	100.00
Colombia: [4]			
Gasoline:			
Standard (New Jersey)	94.21	93.92	94.45
Shell	5.79	5.49	4.14
Total "as is" group	100.00	99.41	98.59
Other marketers		.59	1.41
Total market	100.00	100.00	100.00
Fuel oil:			
Standard (New Jersey)	97.04	97.04	93.69
Shell			6.30
Total "as is" group	97.04	97.04	99.99
Other marketers	2.96	2.96	.01
Total market	100.00	100.00	100.00
Curacao: [4]			
Gasoline:			
Standard (New Jersey)	6.02	15.28	20.76
Shell	93.98	84.72	78.78
Total "as is" group	100.00	100.00	99.54
Other marketers			.46
Total market	100.00	100.00	100.00
Refined oil:			
Standard (New Jersey)	23.54	23.81	16.28
Shell	76.11	75.84	79.72
Total "as is" group	99.65	99.65	96.00
Other marketers	.35	.35	4.00
Total market	100.00	100.00	100.00
Peru: [4]			
Gasoline:			
Standard (New Jersey)	95.18	95.25	97.79
Shell			
Total "as is" group	95.18	95.25	97.79
Other marketers	4.82	4.75	2.21
Total market	100.00	100.00	100.00
Gas and Diesel oil:			
Standard (New Jersey)	98.29	98.29	100.00
Shell			
Total "as is" group	98.29	98.29	100.00
Other marketers	1.71	1.71	
Total market	100.00	100.00	100.00

See footnotes at end of table.

TABLE 31.—*Distribution quotas and trading results for specified products in selected countrifs*—Continued

[Expressed in percentages]

	Base year quotas (trading results in 1928)	Quotas effective Jan. 1, 1936	Trading results, 1936
Venezuela: [4]			
Gasoline:			
Standard (New Jersey)	5.15	33.14	34.35
Shell	77.10	66.49	65.62
T. L. L.	.16		
Total "as is" group	82.41	99.63	99.97
Others	17.59	.37	.03
Total market	100.00	100.00	100.00
Fuel oil:			
Standard (New Jersey)		6.63	5.66
Shell	99.69	93.36	94.34
T. L. L.	.02		
Total "as is" group	99.71	99.99	100.00
Other marketers	.29	.01	
Total market	100.00	100.00	100.00

[1] Both of these French North African colonies appear to have closely held petroleum product markets. The base year quotas in Algeria were twice adjusted for over- and under-trading, the first change being effective on Jan. 1, 1935, and the second on Jan. 1, 1936, the year shown in the table. These adjustments were slight in both cases. The base year quotas in Tunisia were adjusted, effective Jan. 1, 1933, to account for the granting of a quota to an outsider, Steaua Francais, which had entered the market in 1930. This company, however, although adhering to its quota, did not adhere to any of the "as is" rules and hence was regarded as an outsider. The quotas of the "as is" group were readjusted several times for over- and under-trading, the changes being slight in each case, however, so that the 1936 quotas reflect fairly well the 1933 changes. An adjustment in the quotas, effective Jan. 1, 1937, is recorded.

The trading results appear to have followed the quotas rather closely, especially in Tunisia. The 2 products shown accounted for ¾ or more of the total quantity of petroleum products sold annually in domestic markets of these 2 French colonies. In comparison with other countries, the markets in these countries were small.

[2] The Swiss quotas were fixed throughout the 9-year period, 1928–36, at the base-year levels, the only change being that shown in the quotas for black oils, Jersey Standard giving up 6.88 percent to Anglo-Iranian. This was done under a proposal—made by H. E. Bedford to J. C. Clark on Mar. 18, 1935, and confirmed by the latter on Mar. 22, 1935—whereby the difference between Anglo-Iranian's basic quota of 3.12 percent and their quota of 10 percent is to be compensated to SOC (New Jersey) outside of Switzerland.

The two products shown here accounted for 380,931 metric tons out of the total quantity of 432,993 metric tons of all petroleum products delivered for domestic consumption in Switzerland in 1936.

[3] The base year quotas were subject to only 1 change in the 9-year period, 1928–36, this occurring when Anglo-Iranian's quotas were divided between Jersey Standard and Shell, effective Jan. 1, 1932, when Anglo-Iranian withdrew from the market. The 2 products shown accounted for more than 85 percent of the total of 1,705,000 metric tons of petroleum products delivered into domestic consumption in 1936.

[4] The more important petroleum consuming countries in Latin America, aside from those included in the case studies, are the petroleum producing countries whose petroleum economies are dominated by the large producers. The only event affecting quotas and marketing results in the 1928–36 period was the purchase by Jersey Standard from Standard of Indiana of the foreign interests of the latter company's subsidiary, Pan American Petroleum & Transport Co.

These tables and the case histories do not exhaust the cartel statistics appearing in the Jersey Standard documents, Deliveries Into Consumption—Latin America, since all Latin American countries are represented there. The markets in many cases are so small that the statistics are not significant and in other cases are repetitive on a smaller scale of what has already been given.

SUMMARY

The case studies given in this chapter illustrate the widespread development of local cartel arrangements following the conclusion of the Achnacarry or "as is" agreement of 1928. As has been noted, this international agreement on marketing principles was inspired by the price war which had broken out in the Far East, particularly in India.[70] Its principles, which were elaborated upon and modified in subsequent international agreements in 1930, 1932, and 1934, proved applicable in all kinds of markets, in large countries and small, in

[70] See pp. 197–198.

industrialized economies and in agricultural and even "undeveloped" economies.

There can be no doubt that most of the local cartel arrangements were guided by the international agreements. In nearly all petroleum markets of the world, outside of the United States, subsidiaries and affiliates of the principal parties to the international agreements—Standard (New Jersey), Royal Dutch-Shell, and Anglo-Iranian—were predominant forces. Cartel agreements would have been unworkable without their leadership and cooperation. These companies were closely associated in their direction of marketing activities from London—the three companies being described by a Jersey Standard official as a "joint venture"—and were bound to apply the "as is" principles in all local markets. The cartel arrangements universally included quota arrangements designed to freeze the market pattern—the historical position of the marketers—in accordance with that of a "base year" or "qualifying period," which in most cases was the year prescribed in the international agreements, 1928. Most of these distribution quotas were subject to a general revision, effective January 1, 1936, although nearly all changes were minor in character.[71] Other features of the cartel arrangements included provisions to protect the division of the market, such as the agreements to "respect" each other's customers, the fixing of prices, schedules or rebates, discounts, etc., and other selling conditions, the adjustment of quotas for over-and-under trading, the application of a system of fines and compensation in adjustment of over-and-under trading, and the limitation of competitive expenditures for marketing facilities.

"In most cases where there were substantial "outsiders" in the markets, they were brought into the cartel. These important outsiders were occasionally successful in causing modifications or substitutions in various "as is" provisions, but the central principle, that of preserving the historical positions of the participants, always remained. These modifications and substitutions were expressly permitted by the international marketing principle that the interested "as is" parties could enter into such local cartel arrangements by unanimous consent.

This analysis of the origin of the local marketing cartels of the 1930's does not accord with the interpretation advanced by the international oil companies themselves. Lawrence B. Levi, a director of Socony-Vacuum and its executive in charge of foreign operations, speaking for a committee of American oil companies, stated in 1945[72] that the cartels developed out of the following factors: the development of excess productive capacity after the First World War, the relative narrowness and leanness of most foreign markets in comparison with the United States, severe price cutting and "dumping" by the Russians, causing "price wars and wasteful practices," and the development of national economic policies, including such matters as currency and monetary controls, and regulation of markets. He did not mention international marketing agreements, but rather laid great emphasis on the role of governments desirous of attempting "market stabilization within their countries."

[71] These revisions were all adjustments of the 1928 quotas to accord more closely with the current market situation. The universality of the revisions would suggest that they were ordered by the London offices of the companies. One feature of most of the revisions was that the relative positions of the "as is" companies were generally preserved in the 1928 ratios.

[72] Foreign Contracts Act, op. cit., pp. 139–140.

Mr. Levi then went on to state:

Trade agreements which affected the oil industry in foreign countries may be classified under two general headings:

1. By law, i. e., government monopoly or compulsory cartel.
2. (*a*) Trade agreements by government direction of pressure, and (*b*) trade agreements organized by private initiative in accordance with the law of a country [73] and permitted or encouraged by its government.

Thus he interpreted the local cartels as merely the result of compulsive governmental or social forces within each local marketing area. American companies, he said, were forced to go along with these restrictive forces if they wished to stay in business in these countries.

This interpretation omits the role of the international oil companies themselves in the development of the local cartels, as described in chapters VIII and IX of this report. The international agreements were developed partly as instruments to deal with the problems listed by the industry spokesman. These forces were conditioning and limiting factors that determined the form of application and the effectiveness in each case of the cartel arrangements under "as is." It would be difficult indeed to list many of the cartels described in this chapter under the categories listed by the industry spokesman.

The assertion that local customs and usages determined the growth and form of the marketing cartels must also be questioned. In this regard the significance, effect, and form of the local marketing arrangements of the 1930's is much the same as that of the international "as is" agreements.[74] The international "as is" agreements largely determined the character of local cartelization. Local cartel arrangements pursuant to the "as is" agreements were themselves largely determinative of the customs of the trade.

[73] By this he meant, as he subsequently testified, ibid., p. 148, agreements not prohibited by law.

[74] See p. 274.

CHAPTER X

PRICE DETERMINATION IN THE INTERNATIONAL PETROLEUM INDUSTRY

INTRODUCTION

The preceding chapters have described the degree of control over the world petroleum industry held by the seven major international oil companies, their participation in joint-ownership ventures, as in the Middle East, their control over sources of supply through contracts among themselves for the purchase and sale of crude oil, as in the Middle East and Venezuela, their development of world-wide production and marketing agreements, and the application of these agreements in specific countries. Moreover, it has been shown that these major oil companies, through the high degree of concentration of control, through direct ownership, through joint ownership, through purchase and sales contracts, and through production and marketing agreements, have been able to limit production, divide up markets, share territories, and carry on other activities designed to stabilize markets and control production.

In addition, the international petroleum companies have followed a system of pricing which has had the effect of eliminating price differences among themselves to any buyer at any given destination point. Under this system the delivered price to any given buyer is exactly the same regardless of whether he purchases from a nearby, low-cost source or from a distant high-cost source. While the delivered price from all sellers will be different at one destination point as compared with another, reflecting largely differences in freight costs, their delivered price at any given destination point will be exactly the same.

This systematic elimination of price differences has been achieved through the establishment and observance of an international basing-point system, generally refered to as "Gulf-plus." In recent years the system has undergone a number of minor modifications. Nonetheless, since each of the major companies has usually observed these modifications, the system's ultimate effect upon any given buyer has remained the same—the elimination of price differences as among the various sellers.

Under basing-point systems the quotation by sellers, no matter where located, of identical delivered prices at any given point of destination is arrived at in the following manner: A particular producing center (or centers) is designated as "the base point," at which a "base price" is established. The various sellers then arrive at a delivered price by adding to the "base price" the freight charges therefrom to the point of destination. Those sellers who are located nearer to the buyer than the "basing point," reap the advantage of "phantom freight"—i. e., the difference between their actual freight charges to the buyer and the freight charges from the "basing point" to the buyer. Similarly, those sellers who are located farther from the buyer than the "basing point" have to "absorb" freight—i. e., they have to absorb the difference

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between their actual freight charges to the buyer and the freight charges from the "basing point" to the buyer.

As can thus be seen, the starting point in the operation of a basing-point system is the establishment of the "base price" at the "basing point." Hence, the first step in discussing a basing-point system should be an examination of the adequacy and representativeness of this price. In the international petroleum industry the "base point" has generally been United States Gulf, and the "base price" established at United States Gulf has been derived from an American trade journal, Platt's Oilgram.

PRICE REPORTING IN THE OIL INDUSTRY

The trade journal from which the "base prices" are derived in the petroleum industry is Platt's Oilgram Price Service published at Cleveland, Ohio. It has been appropriately described by an industry source as "the framework on which this complex international price structure is carried." The same source further described Platt's price reporting service as follows:

> * * * this is a daily publication of oil prices in the United States, both for the home market, where quotations are given at a number of important sources of supply and centers of consumption, and for the export market where prices are quoted f. o. b. the major oil ports. * * *
>
> Most long-term sales contracts of petroleum products are linked throughout the world, to Platt's f. o. b. prices, and the price fluctuates directly in proportion to the changes in Platt's.
>
> *Even where, for any special considerations, the price of a product is not the same price that it would have been if it had been shipped from the United States*, allowing for freight charges, it is frequently the practice, in a contract which is to spread over a period, *to link the price to the Platt's prices* of a grade selected for reference purposes. This means that even if the sale is not originally directly related to the United States price * * * it is usual in international trade to allow subsequent fluctuations of that price directly in proportion to the movements in Platt's.[1]

It is these widely circulated Platt's price quotations, specifically the "seaboard" prices f. o. b. ship at United States Gulf ports for cargo lots (20,000 barrel minimum) of refined products, which serve as the recognized "base price" for the determination of uniform delivered prices on international sales of refined products. Similarly, Platt's quotations of posted well-head prices at Texas crude fields adjacent to the United States Gulf coast, to which are added the charges for bringing the crude to the Gulf ports, constitute the "base prices" for crude oil—i. e., the f. o. b. United States Gulf coast price for crude.

Crude oil prices, compiled by Platt's from prices posted at the well by leading purchasing companies in each field, appear in Platt publications monthly or whenever price changes occur. Refined product prices, however, fluctuate much more frequently than do crude oil prices. Refined product prices are gathered by Platt's market reporting organization at key seaboard, refinery, tanker and pipeline terminal points, and at major consumption centers of the United States,[2] and are published daily in Platt's Oilgram Price

[1] The Price Structure of the Oil Industry, by R. C. Porten, published in Oil, house organ of the Manchester Oil Refinery, Ltd., England, vol. I, No. 6—reprinted in a special supplement to Platt's Oilgram Price Service of October 24, 1949. [Italics added.]

[2] Platt's covered only domestic prices until February 1, 1950, when for the first time it initiated daily publication of bunker grade fuel oil prices at 44 foreign seaports "from London to Capetown, from Calcutta to Rio de Janeiro." All are prices of Esso Export Corp., (Standard Oil of New Jersey subsidiary), its affiliates and companies with whom arrangements for deliveries can be made through Esso Export, as published in the latter's Marine Fuel Oil Price Bulletin.

Service and weekly in the National Petroleum News. Daily refined product prices carry in the parlance of the industry "high," "low," "mean," or "average" of Platt's quotations to cover the *range* of different prices quoted by sellers at any one time in a given market for each refined product.[3]

Since world prices for refined products are based on Platt's, the following characteristics of Platt's price quotations for refined products should be noted:

1. The prices published are "sales prices or quotations or general offers or posted prices" reported to Oilgram by refiners, and byproduct pipeline and tanker-terminal operators. These are confined to "open spot" transactions and do not include:

   (*a*) Prices arrived at by discounts off a specified price or "market date of shipment."

   (*b*) Prices named in contracts or prices arrived at in accordance with any arrangements made prior to date of sale.

   (*c*) Prices made to brokers.

   (*d*) Prices in "inter-refinery" transactions.

2. During periods of shortage, as in 1947–48, some or all sellers withhold public quotations to new customers or the posting of firm prices, giving Platt's Oilgram only those prices which they otherwise would quote to the trade in general and which they confine to regular customers.

3. Parenthetical figures before and after the prices indicate the number of companies in the Platt sample that quote the lows and highs of the price range. For the most part, only one company appears to have quoted the low and the high at the Texas Gulf coast points—with no indication whether or not the prices of a particular company are consistently used as the low or the high over a long period of time.[4]

These characteristics of Platt's price quotations raise serious questions as to their representative quality and reliability as a barometer of price fluctuations and market conditions. In general, the bulk of international trade in petroleum products, including United States exports, moves under long-term contracts (and mostly between majors and their own or each other's foreign subsidiaries). Yet these transactions are not covered by Platt's quotations. Likewise Platt's does not cover long-term contracts in the domestic markets, or discount or premium prices, or long-term transactions and exchanges between major refiners, or intracorporate transfers between subsidiaries.

What Platt's quotations actually do cover is a relatively thin market, limited to transactions between major or independent suppliers on the one hand and independent United States marketers, foreign refiners, and importers (not affiliated with any of the majors) on the other. Moreover, during periods of shortage the quotations become even less representative by recording only what some sellers would charge *if* trade conditions were different. Though they probably account for but a minute portion of all refined products moving out of United States Gulf coast ports, these quotations are used to establish the "base price" on which price levels all over the world are based.

[3] Except for tank-wagon prices (usually on smaller than bulk lots sold to dealers and gasoline station operators for resale to final consumer), prices are for bulk lots including tank car, cargo lots (tanker), barge and truck transport from refinery or terminal in large quantities.

[4] Cf. Foreword to Platt's Oil Price Handbook (annual).

Indeed, because of Platt's practice of sampling in most instances only one company for price quotations, a single company (probably one of the internationally dominant majors) may, by setting the "base price," determine the domestic and the world price for refined products.

DEVELOPMENT OF BASING POINT PRICING

For several decades the international petroleum industry employed a basing point system for pricing crude oil and refined products in the world's oil markets. The industry is particularly suited to the use of the basing point system because crude oil and refined products of different intrinsic qualities can readily be reduced to standardized commodities. Also the international companies all produce and sell in several areas of the world, and the small number of such companies makes it easy to maintain a basing point system once it is established. Sometimes the industry used a single, and at other times a dual, basing point system, but both have been expedient devices to restrain price competition among the international oil companies.

The history of Gulf-plus

Sometime after 1921 when American output started to expand (more particularly since the rapid growth following 1926), "the price of oil world-wide came to be traditionally determined by the American exporter, that is to say, it was always hitched to the level of American domestic quotations."[5] This system, "which enabled Texas-Gulf virtually to dictate world prices,"[6] required the calculation of world prices, irrespective of the point of origin, as if the oil had come from the United States Gulf.

The end-product of this system has been that sellers, located at different points on the globe, quoted f. o. b. prices which, through the use of fictitious transportation rates, tended to result in identical delivered prices at any given point of delivery, regardless of the differing production or transportation costs actually incurred. A simultaneous consequence is that sales made from sources of supply outside the United States Gulf area result in net receipts (f. o. b. port of shipment prices) varying in amount. For destinations to which transportation costs from an eastern supply point (e. g., Abadan or Haifa) were lower than from the United States Gulf, the eastern supplier had a freight advantage, or "phantom freight." For destinations to which the supplier paid more freight than the United States Gulf supplier he incurred a freight disadvantage, reflected as a lower realization at his shipping point—freight absorption.

The practical elimination of differences in delivered prices derives from several basic common practices followed by all sellers. These include: (1) The common recognition of the United States Gulf as the single, governing basing point; (2) the common observance of the United States Gulf price, as the starting point in the determination of the delivered price; (3) the common recognition and use of the price quotations appearing in Platt's Oilgram as the "official" prices at the United States Gulf; (4) the common use of standard adjustments for differences in quality; and (5) the common use of standard tanker

[5] P. H. Frankel, What Price Oil? The International Structure, Oil Forum, November 1948, p. 438.
[6] Texas-Gulf Remains World Price Barometer, Oil Forum, August 1947, p. 201.

charges (often differing from actual tanker charges or costs) to be added to the basing point price.[7]

In general, these factors so synchronize the operations of the Gulf-plus system that equalized delivered (c. i. f.) prices were established for any given major consuming area, irrespective of the source of supply. This basing-point system not only linked all Western Hemisphere crude and refined products prices, but also those in Europe and the Middle East, directly to the Texas-Gulf price structure. As explained by the Director General of the British Ministry of War Transport before the Committee of Public Accounts, the system operated as follows:

> Before the war the prices at which oil bunkers were sold at ports overseas were influenced by (I do not say that they were absolutely based on, but in ordinary commercial practice they were influenced by) the published f. o. b. prices quoted at production centers in the Gulf of Mexico, to which, of course, there would be added freight and insurance from the Gulf port to the actual bunkering port, in order to give a c. i. f. price. This selling price was applied to all the oil sold at a given port, regardless of its actual source of origin. So the result was that the effective f. o. b. prices of oil derived from some port other than the Gulf of Mexico port differed from the price of the Gulf of Mexico by an amount depending on the geographical position of the source of origin in relation to the port at which the oil was sold.
>
> * * * to take an example: If oil were supplied in Bombay from Abadan in the Persian Gulf, it would normally show a higher f. o. b. return than the Gulf price, because of the low cost of freight from Abadan to Bombay on a very short haul, that freight obviously being much less than a freight from the Gulf of Mexico to Bombay.
>
> On the other hand, if Abadan oil were sold at some point farther away from Abadan than the Gulf of Mexico, then it would normally produce a lower return than the Gulf price, and it is this difference in f. o. b. values which was known in the jargon of the trade as the origin differential.[8]

This pattern of world oil pricing persisted until 1939 with but few minor changes. Though the bulk of Western Hemisphere export trade gradually broadened from the United States Gulf to include other Caribbean sources (principally Venezuela), this did not affect

[7] Precise information as to tanker charges added to the basing-point price from the United States Gulf to yield identical delivered prices during the period between World Wars I and II is not available. It is known, however, that more than 50 percent of seagoing tankers were owned by the major international oil companies and that "a considerable part" of the 40 percent owned by nonoil firms was on long-term charter to the "majors," with the balance consisting of tankers controlled by various governments, and ships carrying molasses, oils, etc. In all, it is estimated that not much more than 10 percent of all loadings were covered by single-voyage charters—a very narrow free tanker market, which accounts for the wide and erratic fluctuations in voyage tanker freight charges. Time charter rates on the other hand (which may be arranged for from 6 months to 10 years and were tied up largely by the "majors") were far less variable, ranging during the period 1923–38 between 5s. and 7s. 6d per month per dead-weight ton. As for the tanker fleets owned by the oil companies, their operating costs, interest and depreciation are all relatively stable. Further stability in the tanker rates at which most international oil shipments moved was introduced by the tanker pool (International Tanker Owners Association) which began to function in May 1936, and continued until the outbreak of World War II. This association of virtually all free owners made it possible to keep up the standard of rates by relieving the pressure of competing tonnage (through payments from a pool to which a part of the earnings per voyage were contributed to reimburse owners who laid up their ships). Thus, an additional measure of stability was introduced into the tanker market already largely controlled by the "majors," who agreed not to charter vessels outside the pool. (See P. H. Frankel, Essentials of Petroleum, pp. 158–163.) Thus, fluctuations in tanker charges entering into the delivered price quoted customers under the "Gulf plus" system before World War II were minimized, thereby minimizing disturbances to the identical delivered pricing structure of the world oil market. After World War II the difficulties introduced by fluctuating tanker freights were virtually eliminated through the use of standard United States Maritime Commission (USMC) rates, set up during the war. As will be shown below, even after the Maritime Commission's authority over tanker rates ceased, USMC rates were used as purely paper rates because of their convenience as a standard reference for the setting of identical delivered world oil prices under the basing-point formula.

[8] The Petroleum Times, London, p. 838, December 9, 1944.

the use of the Texas-Gulf prices as a world yardstick. As described by an authoritative source:

> "The United States Gulf coast price is the world market price because it is the main market where oil is exported. The bulk of this oil goes to the Atlantic seaboard, as does the bulk of the oil exported from the Caribbean area. So these two oils compete on the Atlantic seaboard; and as the freight between Gulf coast and Atlantic seaboard and the Venezuelan coast and Atlantic seaboard are practically the same, the world market price on the Venezuelan coast and on the Gulf coast are the same, with the adjustment of import duties.[9]

The f. o. b. price for Venezuelan crude at Venezuelan ports to all world destinations, whether the United States, Canada, Europe, or elsewhere, was the United States Gulf price for crude of similar quality, less the United States import duty of 10½ cents per barrel.[10] In other words, Venezuelan crude was priced on the "Gulf-plus" base less 10½ cents per barrel, leaving the world crude oil price structure firmly linked to Texas-Gulf price quotations.[11] The prices of refined products were determined in the same manner. Prices at the United States Gulf coast, known as the "low", "mean", or "high" of Platt's, were quoted for refined products at Caribbean shipping points.

The most significant development during the pre-1939 period was the advent of a great new center of production in the Middle East, which potentially posed a threat to the "Gulf-plus" world pricing structure. The major international oil companies, most of whom were interested in production both in the Middle East and in the Western Hemisphere, were obviously not anxious to jeopardize the "Gulf-plus" price structure by competing among themselves in the Middle East, or against their own Caribbean supplies. They did not vigorously push the development of production from their Middle East concessions which would have driven their own Western Hemisphere crude from Eastern Hemisphere markets. The result was that the impact

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[9] Memorandum on Behalf of Petitioner, Compagnie Francaise des Petroles, before the Supreme Court of the State of New York in the matter of the application of Compagnie Francaise des Petroles, for an order pursuant to secs. 1450 and 1452 of the Civil Practice Act, directing that Pantepec Oil Co. of Venezuela, C. A., and Pantepec Oil Co., C. A., proceed with arbitration and designating and appointing an arbitrator, June 30, 1949, p. 23.

[10] Ibid., p. 81. Though a small amount of Venezuelan crude may be sold to non-United States destinations without deducting the 10½-cent duty from the price (i. e., at United States Gulf price), most of it moves at the "ex duty" f. o. b. price, irrespective of destination. This practice has been followed by the industry for over a quarter of a century. It has been explained as follows:

"In addition to the practical problems that would result from any attempt to establish and maintain different f. o. b. prices based on destination, and to the reluctance of producers who value good will to discriminate among their customers, there is another immediately obvious reason why sales for delivery outside the United States are not made at a figure 10½ cents above the price on sales to United States buyers. Unless all major Venezuelan producers were to establish and maintain such a price differential, competition would prevent any one of them from attempting to do so." Based on testimony of Max. W. Ball, ibid., pp. 80–81.

[11] A notable exception to the "United States Gulf plus" formula before World War II was the establishment of a base price, f. o. b. Constantsa, Rumania, during the early 1930's. Rumania was the only country (outside of the U. S. S. R.) with an exportable surplus of crude produced by a relatively large number of local producers and only partly controlled by the majors. However, Rumanian exports, even at their peak, were of sufficient magnitude to affect only nearby markets. Their prices, "if they were not manipulated by the big firms, were adulterated by continuously changing export duties." Frankel, Essentials of Petroleum, p. 146, f. n. 16. Moreover, the Constantsa f. o. b. price was not entirely independent of the United States Gulf price, particularly when considered in the light of the Rumanian petroleum cartel and Rumania's participation in the international proration schemes of the early 1930's under which her output was restricted and price stabilization attempted. Like the Rumanian exports, Russian shipments abroad, which expanded materially during the depression period of the early thirties to a peak of about 40 million barrels annually, receded to insignificant proportions by 1939, as internal consumption climbed with expanding industrial operations. See Petroleum Requirements—Postwar, hearings before Special Committee Investigating Petroleum Resources, United States Senate, 79th Cong., 1st sess., pursuant to S. Res. 36, October 3 and 4, 1945, p. 104.

of Middle East production on the prevailing "Gulf-plus" price structure was postponed for years by the limitations on the rate of Middle East output imposed by the major oil companies. As a British writer has summarized the matter:

> * * * It is difficult to say what would have happened had production in the Middle East not been in the hands of companies which had strong interests in the Western Hemisphere, companies like Jersey Standard, Socony-Vacuum, and Shell and later on California Standard and the Texas Co., or who, like Anglo-Iranian, knew better than to go all out on their own.[12]

Consequently, crude (as well as refined products) continued to be priced until the outbreak of World War II as if it came from the Caribbean area, with all price competition at every given world market eliminated. Thus the buyer in the Middle East paid the same delivered price for oil shipped from Middle East sources as from Texas, Venezuela, or any other source of production, with the delivered price of Middle East crude rising and falling with Texas-Gulf posted prices. On shipments from the Middle East the netback (net realization) was higher the shorter the distance from the Persian Gulf and the longer the distance from the United States Gulf to any given market. Even though the oil they purchased came from the Middle East, Mediterranean buyers continued to pay more for their crude f. o. b. loading port than purchasers in Western Europe. Dr. Frankel appraised this price discrimination as follows:

> It is obvious that in a free market with supplies readily available and producers keen to sell, there would eventually be a tendency for only one f. o. b. price level to be effective to all destinations. *In the absence of agreements to the contary this would be inevitable* as prices in the more remunerative areas would, by competitive trading, be forced down to almost the marginal level.[13]
>
> It is obvious that such price discrimination was possible only if it was practiced uniformly by *all* operators, since otherwise each of the competitors would have endeavored to increase his sale in the more remunerative markets, a tendency which, according to the classical pattern, would have led to such "premium" being wiped out and a single price being established.[14]

A New Basing Point—The Persian Gulf.

While the basic feature of the "Gulf-plus" basing point system—the quotation of identical delivered prices at any given point of destination—remained unchanged, a number of minor modifications were made in its operation, beginning in the middle of World War II. The first of these modifications was the establishment of a new basing point at the Persian Gulf for bunker fuel oil.

During the period following the outbreak of hostilities in 1939, military operations in the Mediterranean practically eliminated large-scale shipments of Middle East oil to the western Mediterranean and western Europe—a type of movement which, under Gulf-plus, involved freight absorption. At the same time, shipments from the Middle East to nearby Eastern Hemisphere markets, involving large elements of phantom freight, were substantially increased.

This shift in the geographic distribution of most Middle East oil, and the fact that the prices paid for that oil now included payments for phantom freight, led British authorities to question the propriety

[12] P. H. Frankel, American Oil in a Changing World, Oil Forum, November 1950, p. 446.
[13] Oil Forum, November 1948, p. 457. [Italics added.]
[14] Oil Forum, November 1950, p. 448.

of the Gulf-plus price structure as applied to Middle East oil. In the language of the British Auditor General during the war:

> Before the war the price of oil f. o. b. in the Gulf of Mexico was the generally accepted basis regulating the prices of commercial supplies of oil in the Atlantic area. It also influenced, under competitive conditions, prices in other areas.
>
> In the course of their inquiries the Committee found that in many cases the price of bunker oils charged or proposed to be charged to the Ministry at ports in the Indian Ocean and Middle East included an element described as an origin differential. This differential (which did not represent actual costs incurred by suppliers, and which applied to all oil products, and not solely to bunker fuels) was a means of equating c. i. f. prices, whatever the point of production. The general result was that when the source of supply was more distant than the Gulf, the application of the differential would operate to the disadvantage of the supplier and, when it was nearer, to his advantage.[15]

The main concern of the British appeared to be with the problem of phantom freight and of cross-hauling engendered by a straight Gulf-plus system. This concern is reflected in a further statement by the Director General:

> * * * We could no longer accept this origin differential automatically as a proper element in bunker prices in overseas ports, mainly because owing to the vital necessity for getting the utmost possible service out of tanker tonnage it was a matter of policy and principle to draw supplies from the nearest available source. It was no longer a matter of commercial competition. It was a matter of imposed policy that every ton of oil that could be drawn from a near source had to be taken from that source, and from none other. * * *[16]

The outcome of this British action was the establishment of a second basing point at the Persian Gulf. As to the *level* of the base price at their new basing point, the British Government which, after long discussions with the oil interests had failed to bring to light the actual cost of production at the Abadan refinery, agreed "to accept" as the Persian Gulf base price the United States Gulf base price. As stated in the report of the Auditor General:

> In view of the difficulty of arriving at production costs and in the knowledge that f. o. b. prices in the Gulf of Mexico were controlled by the United States Government at levels giving a fair return, the committee accepted f. o. b. prices for Persian Gulf production centres approximating the f. o. b. prices in the Gulf of Mexico.[17]

The dual basing-point system for bunker fuel, while eliminating a highly discriminatory element of phantom freight, did not, as the British apparently presumed, eliminate the origin differential. Freight absorption and differences in net realization at the Persian Gulf continued to exist on shipments to destinations which were freightwise closer to the United States Gulf. The basic result of the Gulf-plus system continued to be realized, i. e., the quotation of identical delivered prices for each destination regardless of supply source.

The propriety of the Persian Gulf price

The dual basing point established at the insistance of the British in the Persian Gulf for bunker fuel was extended to apply to other refined products and crude oil in 1945. The acceptance of the Gulf figure as the base price at this new basing point for crude and refined products came in for sharp criticism, particularly with regard to sales

[15] Adjustment in Prices of Bunker Oil Supplies, in the (London) Petroleum Times, May 13, 1944, p. 298.
[16] Ibid.
[17] Ibid., The Petroleum Times, London, May 13, 1944, p. 298.

to the United States Navy. Behind this criticism, which found expression during the course of a 1947–48 congressional investigation (popularly known as the Brewster hearings and reports),[18] was the belief that costs were lower in the Middle East than in the United States and that the United States Government, in purchasing Middle East oil, should gain the benefit of these lower costs. The question of crude oil prices centered in the negotiations leading to United States Navy purchases from Arabian American Oil Co. in 1945 for delivery to the French Government under the Lend-Lease Act.[19] These hearings were directed specifically into charges that the Navy had paid excessive prices for crude oil and petroleum products to companies holding concessions in Saudi Arabia and the island of Bahrein, Information developed at the hearings revealed that the cost of production of Saudi Arabian crude was about 40 cents per barrel, *including* a royalty of 21 cents. The cost of producing a barrel of Bahrein crude, *including* a royalty of 15 cents, was estimated to be approximately 25 cents per barrel.[20] These costs become significant when compared with the selling prices of $1.05 per barrel and upward which the Navy was required to pay for crude and products from Saudi Arabia and Bahrein.

Arabian American Oil Co., at that time a jointly owned subsidiary of the Texas Co. and Standard Oil Co. of California,[21] held a concession in Saudi Arabia which was just beginning to develop into an important producing area, for which no price policy had been established. But with the end of the war approaching and with the rapidly expanding crude production of Saudi Arabia requiring world market outlets, it was important for the controlling oil companies to establish a price policy for Saudi-Arbian crude and set a precedent that would apply not only to future Government sales but to private sales as well. As the Navy had made no previous purchases of crude from Aramco, it was aware that the first contract would serve as a precedent for future dealings in Middle East oil.

Evidence abounds in the Senate committee hearings [22] that throughout the period of protracted negotiations, the aim of the oil company was to maintain the principles of the dual basing-point system—that is, to establish a base price in the Persian Gulf for crude *at the same level* as the United States Gulf price, thus paralleling the price structure for bunker fuel established in World War II at the insistence of the British. Thus Aramco offered to supply the crude for $1.05 per barrel f. a. s. Persian Gulf, or the same as the United States Gulf price for West Texas crude, after allowing for differences in quality and cost of moving the oil from wellhead to loading port. The Navy pro-

[18] Petroleum Arrangements With Saudi Arabia, pt. 41 of hearings before a special committee investigating the national defense program, United States Senate, 80th Cong., 1st sess., pursuant to S. Res. 46, March–November 1947, and January 1948; and Navy Purchases of Middle East Oil, S. Rept. No. 440, pt. 5, 80th Cong., 2d sess., of the same committee, April 1948.

[19] The Navy was assigned procurement responsibility for petroleum products under the Lend-Lease Act.

[20] Petroleum Arrangements With Saudi Arabia, op. cit., pp. 24978–25032.

[21] Standard Oil (New Jersey) and Socony-Vacuum have since bought a 30- and 10-percent interest, respectively, in Aramco. The March 1947 conditional contract for their purchase of Aramco stock became final in December 1948.

[22] See Petroleum Arrangements with Saudi Arabia, op cit., pp. 25172 and 25412.

curement officers[23] made an attempt through sources inside and outside Government to determine the reasonableness of the Aramco quotation. Officials of the Shell Oil Co. and its subsidiary, Asiatic Petroleum, when asked for price information on British-controlled Middle East crude, advised the Navy that the British would accept the dual basing-point system, with the Persian Gulf base price equivalent to the United States Gulf:

> * * * the British would base the value of such crude f. o. b. vessel Iran/Iraq on United States Gulf seaboard price for a comparable quality crude.[24]

During its negotiations with Aramco, the Navy received information from the Petroleum Administrator for War (PAW) as to the cost of production of Arabian crude, accompanied by PAW experts' findings that a price of $1.02 per barrel was excessive.[25] This information was based on an exhaustive analysis conducted by PAW in 1943 into the costs and proper evaluation of Arabian crude (supplied by Aramco to Bahrein Petroleum Co.).[26] The analysis had been made in order to determine the price to be paid by Defense Supplies Corporation for 100-octane gasoline produced at Bahrein's new refinery, constructed mainly with United States Government financing. PAW cost experts rejected a 1943 evaluation of Arabian crude at $1.02 per barrel based solely on equivalent Texas crude price quotations[27] (as incorporated by Bahrein in its aviation gasoline-costing calculations), because—

> * * * *it appears to us that its comparative value with reference to domestic crude is not a proper criterion and because the prewar sales of Arabian* crude * * * were at prices considerably lower than $1.20 *per barrel.* Specifically we understand that the company owing the Arabian crude had a contract with a Japanese firm calling for the sale of a large volume of this crude at 86 cents per barrel f. a. s. the Arabian coast. We further understand that this contract was canceled by the Japanese as a result of pressure exerted on Dutch East Indian sources of crude oil, and as a result of these factors two cargoes were shipped to the Japanese at a price of 70 cents per barrel f. a. s. the Arabian coast. We do not believe that these latter sales (or certain other small sales which we understand were made for shipment to Mediterranean ports) represent a fair index to the market value of the Arabian crude but *we have taken the position that this crude oil should not be evaluated at a price higher than the 86-cents-per-barrel figure contained in the large-scale contract referred to above.*[28]

The Navy negotiator's attempts to obtain substantiating cost information from Aramco's sales manager were rebuffed on the grounds that such data were unavailable. Later the company's vice president testified before the "Brewster committee" that cost figures were compiled monthly for the directors, and the costs were only 40.6 cents per

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[23] Conducting negotiations for the Navy was Commander A. A. MacKrille, officer in charge of the Purchasing Section, Fuel and Lubricants Division, of the Bureau of Supplies and Accounts. Petroleum Arrangements With Saudia Arabia, op. cit., pp. 25161 and 25162.

[24] Petroleum Arrangements With Saudia Arabia, op cit., p. 25412.

[25] However, the Brewster committee found that the PAW had no intimation that the Navy was negotiating the purchase of oil from Aramco, nor was it advised that the Navy was being charged $1.05 for Arabian crude.

[26] Both Aramco and Bahrein were owned jointly by the same companies, Standard Oil of California and the Texas Co.

[27] Equivalent to $1.25 East Texas crude prices, allowing for quality differences.

[28] *Navy Purchases of Middle East Oil, op. cit.*, pt. 5, p. 20 [italics added]:

"With the contingency allowance of 1.25 cents per gallon and other costs evaluated on a basis consistent with domestic production and favorable to Government, the 13.75-per-gallon price for the 100-octane aviation gasoline contains an allowance for raw materials equivalent to a price of slightly less than 84 cents per barrel for the Arabian crude f. a. s. the Arabian coast. While it is impossible to say that this is or is not exactly the proper price, we believe it is completely justifiable, since it is less than the price involved in the only large volume commitment entered into prior to the war, namely, 86 cents per barrel" (*Petroleum Arrangements With Saudi Arabia, op. cit.*, exhibit No. 2582, pp. 25414–25415).

barrel at the time the Navy was required to pay $1.05. Had the company disclosed these costs to him, testified the Navy representative, he would have refused to pay the quoted price.[29] But, confronted by Aramco's uncompromising "take it or leave it" attitude, and informed by his superiors the oil was unobtainable elsewhere, the Navy negotiator felt compelled, because of the urgent need, to agree to the company's original quotation.[30]

In passing, it should be noted that the $1.05 price was not only far above Middle East costs and substantially above contract prices on previous sales; it was also well above actual offers to sell to the United States Government previously made by Caltex and the Texas Co. Thus, in 1941, James A. Moffett, chairman of the board of Caltex (jointly owned by Standard of California and Texas Co.), offered to sell products to the United States Navy at special prices: Gasoline at 3½ cents a gallon, Diesel oil at 75 cents per barrel, and fuel oil at 40 cents per barrel. Again in 1943, W. S. S. Rodgers, chairman of the board of the Texas Co., offered to sell Aramco crude and products to the United States Government "at an agreed-upon percentage of the going price in the world markets. * * *."[31]

The United States Government was an interested party in the world pricing of refined products as well as crude. Since 1942 the United States Navy had made substantial purchases of refined petroleum products from the subsidiaries of American companies operating in the Middle East, and the products were lifted by the Navy's own tankers. From early 1942 until the middle of 1945, Caltex was the chief Navy supplier of Middle East products at special contract prices, somewhat below United States Gulf f. o. b. quotations. But the acceptance of the $1.05 crude price established a dual basing point for crude oil and had a precedent-setting effect upon the prices of refined products in the Middle East. This is indicated, for example, by the prices called for in the initial contract for refined products from

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[29] However, the overriding consideration, as stressed in the Navy's official "justification" for recommending acceptance of the $1.05 price asked, was an alleged 21 cents per barrel increased royalty to the Saudi Arabian Government, which was actually not being paid. The official Navy report said: "This group [various executives of Aramco and its parent companies] stated that they considered the original pricing of crude oil for 100-octane aviation gasoline for the Defense Supplies Corporation—that is, January 1943—a reasonable and adequate justification for contractor's quotations to Navy, particularly since current royalties to the King of Arabia are now totaling approximately 42 cents per barrel, as compared to the former 21 cents per barrel applicable during the period of negotiations of the DSC contract. In addition, it was reported considerable pressure is being placed on Arabian American to further increase such royalty" (Petroleum Arrangements With Saudi Arabia, op. cit., p. 25412).

Though officials of Aramco or its parents denied making the statement that the royalty had increased, the Navy report written by Lieutenant Bodenschatz (associated both before and after his Navy service with the General Petroleum Corp., a wholly owned subsidiary of Socony-Vacuum) speaks of current royalties having increased 21 cents since the PAW analysis of the Bahrein-DSC contract in 1943. Commander MacKrille (with the Shell Oil Co. since 1930 except for the period of his Navy service), who conducted the negotiations for the Navy with the oil company officials, apparently never read the typed report, claimed some "mistake" in "Lieutenant Bodenschatz's understanding of what I said, or in transcribing" re the royalty increase; but he recalled that Mr. Denham, sales manager of Aramco, told him the royalty might be doubled and the company was under pressure to increase it. As the testimony revealed that no increase in royalty had actually taken place, the committee found that the justification for an increase in Arabian crude prices to $1.05 per barrel "was based on incorrect facts and was entirely without foundation." (See Navy Purchases of Middle East Oil, op. cit., pp. 20–21; and testimony in Petroleum Arrangements With Saudi Arabia, op. cit., pp. 25148–25153 and 25181–25182.)

[30] (Navy Purchase of Middle East Oil, op. cit., pp. 19–22.) The Brewster committee found that "The testimony indicated clearly that the Navy officers were far from diligent in seeking cost records from Aramco. Millions of dollars might have been saved the taxpayers had the Navy insisted on or demanded the cost figures prior to the execution of the contract for $1 05 per barrel of crude oil. This failure established a 'bottom price' for that commodity, and it has remained as a basing price since in all other procurements from the Arabian oil fields" (p. 23).

[31] Ibid., pp. 4 and 12.

Aramco's new, modern refinery at Ras Tanura, Saudi Arabia. Entered into on September 13, 1945, at the time when petroleum products were in critical short supply, the refined products contract called for f. o. b. Ras Tanura prices on 80-octane motor gasoline (6½ cents per gallon), fuel oil special ($1.05 per barrel), and Diesel oil ($1.68 per barrel) "*at the minimum United States Gulf-coast prices for products of similar grades in tanker lots.*" [32]

As the Brewster committee concluded:

> It was agreed by the Navy representatives that the first contract for $1.05 for crude was largely determinative in the fixing of these prices. In its first sale of refined products, as in the sale of crude oil, Aramco did not furnish these products at the prices quoted in the Moffett offer of 1941 nor at "prices well below world prices" as set forth in the 1943 Rodgers proposal. In fact, the prices were much higher than those the sister corporation, Caltex, had charged in prior years. The latter corporation furnished from Bahrein's refinery fuel oil special for 85 cents per barrel and Diesel oil at $1.25 per barrel from May 1942 to July 1944, and had supplied the Diesel fuel between March and July of 1945 at $1.57½ per barrel.
>
> Caltex was solely a marketing agent and had been in that part of the world for sometime. Aramco, a virtual newcomer in the marketing field, on its first major transaction with the Navy, *established the United States Gulf coast price for the Persian Gulf area. This action by Aramco had a marked effect. Cal-Tex in its next Navy contract commencing October 1, 1945, closed at prices identical with the price established by the first Aramco contract.*[33]

For the entire period between January 1942 and June 30, 1947, Caltex and Aramco, both owned jointly by Standard Oil Co. of California and the Texas Co., sold approximately $70 million worth of petroleum products to the United States Navy. This valuation was about $38.5 million higher than would have resulted from the special prices proposed under the wartime Moffett proposal.[34]

In all, it is evident that had prices in the Middle East been determined by competitive influences bearing some relation to the low cost of production of Middle East oil, substantial savings could have been effected by the United States Government on Navy purchases. Instead, with Middle East suppliers using as their base price the United States Gulf figure, the difference between the low cost of Middle East production and the far higher costs in the United States Gulf output, was intercepted by the major oil companies operating in the Middle East.

CRUDE OIL PRICING AFTER WORLD WAR II

Until the end of World War II, developments affecting the world crude oil price structure were similar to those affecting the pricing of refined products and the discussion of these developments was presented simultaneously in preceding sections. However, since the end of World War II the story of crude oil pricing departs considerably from that relating to refined products. Accordingly, the discussion of crude oil pricing and refined products pricing in the postwar period will be divided into separate sections. One will deal with crude oil and the other with refined products.

Increases in Production and Prices in the Middle East

Immediately following the war two significant developments profoundly affected the world crude price structure. The first was the expansion in Middle East output; the second was the rapid series of

[32] Navy Purchases of Middle East Oil, op. cit., p. 23. [Italics added.]
[33] *Navy Purchases of Middle East Oil,* op. cit., p. 23. [Italics added.]
[34] Ibid. p. 24.

crude price increases in the United States which were soon reflected in higher prices for Middle East oil.

With regard to the former, Middle East crude output increased from 4.8 percent of total world crude production in 1940 to 12.2 percent by 1948. Once the critical supply shortages of 1945–47 began to ease, this increased flow of Middle East crude could only be absorbed in the major consuming areas of western Europe, and later the United States.

The need for finding western European and United States markets for Middle East crude led to a change in the world pricing structure. As has been noted, a new basing point, with a base price equal to United States Gulf, had been established during the war at the Persian Gulf. Although this dual basing point system eliminated phantom freight on shipments of Middle East crude to the eastern Mediterranean, it tended to prevent shipments from the Middle East to the western Mediterranean, to western Europe, and to the United States. Under the dual system as it then existed, deliveries of Middle East oil westward beyond the mid-Mediterranean (i. e., southern France, western Europe) required the absorption of freight, since the United States Gulf was nearer (freightwise) to those markets than the Persian Gulf. Thus, as long as their system remained, the companies operating in the Middle East were faced with the prospect of having to absorb freight and take a lower net price in disposing of their rapidly expanding output in the markets of western Europe and the United States. Modifications of the basing point system which would permit a freer movement of Middle East oil into western markets seemed to be in order.

The second postwar development affecting the world crude price structure was the rapid series of increases in the United States Gulf crude price—to which world crude prices were linked—following the lifting of OPA controls.

The upward spiral in Middle East prices, reflecting these increases in United States Gulf prices, began with an action by Aramco raising its Persian Gulf price for the contract period December 1946–March 1947, from $1.05 to $1.17–$1.23 (depending on gravity) for crude oil sold to the Navy for UNNRA. For a time nonuniform Persian Gulf crude quatotions prevailed, as Caltex,[35] Socony-Vacuum and Esso Export [36] raised their Middle East crude oil prices at different times, in a lagging pursuit of the rapidly rising American crude oil price level.[37]

On December 6, 1947, just 5 days after the last 50 cent increase in United States crude prices, Esso Export, a newcomer in the Persian Gulf, raised its Persian Gulf crude prices to a record $2.22 per barrel on shipments to Italy—93 cents above the previous high of $1.29.[38]

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[35] A subsidiary of Bahrein Petroleum, marketing Middle East oil produced for the account of Standard Oil of California and the Texas Co. by Bahrein and Aramco.

[36] Subsidiary of the Standard Oil Co. (New Jersey).

[37] Absolute increases in f. o. b. Persian Gulf prices may not have kept precise pace with the rapid increase in American crude prices because of the contractual manner by which industry related the two. The usual contract for Middle East crude carries an "escalation" clause specifying that the f. o. b. Ras Tanura price shall be adjusted upward or downward by the mean average price change of east Texas crude and west Texas sour crude (adjusted for differences in API gravity). At times the contract calls for escalation to start only after a certain price level is reached in the United States.

[38] The emergence of Standard Oil Co. (New Jersey) through its subsidiary, Esso Export, as a leader in pricing of Persian Gulf crude took place shortly after Standard Oil (New Jersey) and Socony, on March 12, 1947, agreed to buy into Aramco (upon settlement of claims of certain IPC partners), and Trans-Arabian Pipe Line Co. (Tapline), and to purchase from Aramco and Cal-Tex (under the interim off-take agreement) specified quantities of crude, starting in August 1947. See pp. 119–128. With crude thus made available to "Jersey," in the Persian Gulf for the first time, Jersey took the lead in setting the crude pricing pattern in that area.

Socony followed Esso's lead in February 1948 while Caltex, after initially raising its price to \$1.59, did not reach the \$2.22 level until March 1948. Before the ECA program was initiated, all major Middle East producers had established a uniform price of \$2.22 f. o. b. Ras Tanura, representing an aggregate increase of \$1.17 per barrel over the July 1945 Aramco-Navy contract price. This increase was somewhat less than the rise of \$1.40 in United States Gulf crude quotations over the same period.

Prices equalized at United Kingdom (the \$2.22 price)

These price increases, culminating in the \$2.22 price f. o. b. Ras Tanura, were made in such a way as to reflect a new modification of the basing-point system. Under this modification, delivered prices from the Middle East and the United States were "equalized" at the United Kingdom. This result was reached through the use of a rather complicated pricing formula: to the United States crude price was added the United States Maritime Commission [39] freight rate from the United States Gulf to the United Kingdom, from which was then deducted the United States maritime freight from Abadan to the United Kingdom. In other words, this formula calculated the net realized price accruing to Middle East oil when delivered prices were equalized at the United Kingdom, and fixed the f. o. b. price at Ras Tanura at this figure.

Theoretically, the change from the old dual basing point system, with the Persian Gulf base price the same as the United States Gulf base price, to a Middle East price equalized in England with comparable Caribbean crude should have meant a *decrease* in the Persian Gulf f. o. b. price. Under the old dual basing point system, the point at which the Persian and United States Gulf prices were equalized was the mid-Mediterranean. The change of this point of equalization to England would theoretically have meant a reduction in the Persian Gulf f. o. b. price.[40]

This change in the method of determining the Persian Gulf f. o. b. price did not actually result in a price reduction, however, because its effect was more than offset by the rising level of United States Gulf prices, to which the Persian Gulf price was linked. Thus, the increase in the Middle East price to \$2.22 represented the effect of both of these price factors: (*a*) It incorporated a theoretical downward adjustment resulting from the equalization of the delivered price at Great Britain instead of at the mid-Mediterranean; and (*b*) It raised the Persian Gulf base price to a much higher level than before, reflecting the increases which had taken place in the United States Gulf price follow-

[39] United States Maritime Commission tanker rates were established shortly after World War II by the Maritime Commission for its then sizable tanker fleet. "Current freight rates" on the spot tanker market, and tanker rates charged by the major oil companies for their own huge tanker fleets fluctuate substantially above and below the USMC rates. The latter, nevertheless, have been used as standardized rates to achieve "equalized" delivered prices in the major markets under this and succeeding price formulas.

[40] The amount of this reduction would have been equal to the sum of (a) the amount of the reduction in equalized prices occasioned by shifting the Gulf-plus point of equalization from the mid Mediterranean to England, and (b) the amount of *increased* freight costs on Persian Gulf oil occasioned by the fact that the point of equalization was now more distant from Persian Gulf shipping points.

Example: Assume that the United States Gulf export price is \$2 and that the freight rates from the United States Gulf to the mid-Mediterranean and to England are, respectively, \$0.20 and \$0.15. Assume further that the freight rates from the Persian Gulf to the mid-Mediterranean is \$0.25, and to England, \$0.30. Then, if prices are equalized at the mid-Mediterranean, the equalized price would be \$2.20 and the Persian Gulf f. o. b. price would be \$2.20 less \$0.25, or \$1.95. If the point of equalization is shifted to England, however, the equalized price becomes \$2.15 and the Persian Gulf f. o. b. price becomes \$2.15 less \$0.30, or \$1.85.

ing the lifting of OPA controls. Thus, although middle eastern suppliers had to absorb more freight than before owing to the change in the point of equalization, they could well afford to do so because of the higher level of the Persian Gulf base price.

The basic formula by which the $2.22 price was established has persisted up to the present (October 1951) despite a number of price reductions in Middle East crude during the past three years, partly induced by the Economic Cooperation Administration.

Central to the system is the concept of equalizing at a selected market the delivered price of crude from the two major production areas with exportable surpluses, the Middle East and the Western Hemisphere, particularly Venezuela. A second common element in the system is the use of USMC freight rates in calculating what Middle East price will yield identical delivered prices at the selected market area. However, actual freight charges, as will be shown below, vary widely from the USMC rates, thus adding an element of artificiality in any delivered price based thereon. Moreover, the system, by maintaining a fixed relation between Persian Gulf and American domestic crude price levels, insures that Middle East prices will remain firmly linked, in their fluctuations and in their general level, to United States Gulf prices. Finally, the formula preserves the essential characteristics of all basing-point systems—the quotation at any given point of destination of identical delivered prices from all sellers, regardless of whether they were located in the Middle East, Venezuela, the United States, or elsewhere.

Change in freight rate (the $2.03 price).—Since the establishment of the $2.22 price, the f. o. b. price for Middle East oil has undergone a number of reductions, most of which have occurred as a result of a change in the equalization point or in the route of shipments calculated under the formula.

The uniform $2.22 price at the Persian Gulf continued until May 1948, when Caltex, at that time the largest single marketer of Middle East crude, cut the price 19 cents to $2.03 per barrel of 36° (API) Arabian crude. By November 1948 all of the major oil companies were charging $2.03 as the prevailing market price on the Persian Gulf.[41]

This price reduction from $2.22 to $2.03 involved nothing more than the substitution of a slightly lower Caribbean to United Kingdom freight rate in place of the United States Gulf to United Kingdom freight (both at USMC rates), as well as a change in loading ports from Abadan to Ras Tanura.[41a] The point of equalization continued to be the United Kingdom. As Eugene Holman, president of the Standard Oil Co. (New Jersey), explained it:

> Our announced f. o. b. prices for crude-oil supplies at the eastern Mediterranean or Persian Gulf are equivalent to the Caribbean price for crude plus freight at published United States Maritime Commission rates from the Caribbean to western Europe less freight on the same basis from either the eastern Mediterranean or the Persian Gulf depending on the supply point to western Europe.[42]

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[41] Unlike Caltex, the other majors failed originally to allow for the quality differential arising from the fact that refinery yields of Arabian crudes run approximately 4 cents less than Oficiana (Venezuelan) or west Texas sour crudes in terms of product value. Taking these into account reduces the $2.07 price for 36° (API) Arabian crudes to $2.03 based on price equalization at the U. K. with Venezuelan crude petroleum. The $1.99 price, also widely used during this period applied to 34° (API) crude, allowing 2 cents per degree of gravity.

[41a] The companies follow the practice of charging the same f. o. b. prices at all Persian Gulf ports despite differences in freights.

[42] Quoted in the Oil and Gas Journal, July 15, 1948, p. 56.

ECA pressure ($1.88 price):—By the latter part of 1948, with world crude production increasing beyond the capacity of markets to consume at existing price levels, crude-oil production curtailment was instituted in the United States as well as in South America. As Middle East output continued to expand, the Eastern Hemisphere was transformed from a net deficit importing area from the Western Hemisphere into an exporting area. Significant quantities of Middle East crude began moving to United States eastern seaboard refineries (increasing from under 600,000 barrels per month in April 1948 to over 4,000,000 barrels per month by December of that year) at net realized prices below those prevailing on shipments to European markets which were financed primarily by ECA.

Beginning in December 1948 and continuing through July 1949, crude oil production allowables in the United States were cut back each month, until about 1,000,000 barrels daily of United States production had been shut in.[43] Production was also reduced in Venezuela. Although some minor reductions were made in Middle East production in the early months of 1949, they were nominal in character, representing in some instances no more than an interruption of future expansion plans.[44] In general, most of the downward adjustment in world crude-oil production was made in the United States where costs are, of course, higher than in the Middle East. For the international companies the adjustment thus meant a reduction in their high-cost output while production in the low-cost Middle East area was maintained at a high level.[45] Moreover, the curtailment of production in the United States tended to strengthen and support the United States Gulf price—the basic underpinning for the Middle East price. One observer, in commenting upon the industry's position in early 1949, stated:

> * * * With cut backs in crude-oil production, the industry hopes that it will be able to maintain prices * * *. Involved in the apparent strategy to hold prices, however, is the ability to prevent an excess of crude-oil production in Texas and Venezuela, while at the same time expanding the output of the Middle East. Although the cost of producing crude oil abroad is much less than in the United States, there is the chance that imports at the present rate may not have a decided influence on prices of any products except heavy fuel oil. This is contingent upon the ability of the regulatory bodies of the oil-producing states to hold production in check so that a large proportion of the excess foreign production may be absorbed here until it can be marketed advantageously outside the United States.[46]

Throughout the last quarter of 1948 and for the first quarter of 1949 imports of crude oil into the United States from the Middle East averaged approximately 4 million barrels per month.[47]

In this connection, it will be recalled that the costs of producing Saudi Arabian and Bahrein crude were estimated in 1946 to be 40.6 cents and 25 cents per barrel, respectively. The cost of producing and

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[43] H. Rept. No. 2344, 81st Cong., 2d sess., Effect of Foreign Oil Imports on Independent Domestic Producers, a report of the Subcommittee on Oil Imports to the Select Committee on Small Business, House of Representatives, 81st Cong., pursuant to H. Res. 22, June 27, 1950, pp. 36–37.

[44] See New York Journal of Commerce, April 14, 1949, p. 14–A, and April 22, 1949, p. 11; also the Oil and Gas Journal, February 17, 1949, p. 77.

[45] United States production declined from 2,020,185,000 barrels in 1948 to 1,841,940,000 barrels in 1949, a reduction of 178,245,000 barrels. Middle East production, however, increased 94,713,000 barrels in 1949 over 1948. See World Oil, July 15, 1951, p. 52ff.

[46] From Oil Industry Seen in Price Quandary, an article by J. H. Carmical in the New York Times, January 25, 1949.

[47] U. S. Department of Commerce Monthly Report No. FT 110, United States Imports for Consumption of Merchandise.

gathering Kuwait crude was estimated in 1946 to be approximately 27 cents per barrel.[48] It is significant, therefore, that a major portion of the crude oil imported into the United States in 1948–49 from the Middle East came from Saudi Arabia and Kuwait, where costs were estimated to range from 27 cents to 40.6 cents per barrel. Furthermore, as shown in earlier chapters, some of the major importing companies were restricted as to the quantity of Middle East oil they could market in the Eastern Hemisphere. Hence, the pressure to import into the United States was increased.

The establishment of ECA early in 1948 and the allotment of substantial sums for the dollar financing of crude oil purchases by European refineries had made the question of Middle East oil prices a matter of public interest and scrutiny.[49] More than 94 percent of ECA-financed bulk oil shipments to Europe, for the year ending April 2, 1949, were made by six of the seven major international oil companies, nearly all of which took the form of shipments to their own affiliates or subsidiaries. For the first time the world oil-pricing structure became a matter of open public interest and was widely discussed outside of the trade press.

ECA, as well as congressional committees, became concerned about a pricing formula under which Middle East crude shipments to Europe financed by ECA were netting a higher price f. o. b. Persian Gulf than privately financed shipments to the United States.[50] The lower net prices on Middle East shipments to the United States as compared to Europe resulted of course from the greater amount of freight absorption involved. As expressed by ECA Administrator Hoffman in his statement before the Senate Foreign Relations Committee on February 17, 1949:

> ECA has taken the position in respect of offshore procurement that not only must each transaction submitted to it for financing meet the American market

[48] Cable from L. C. Stevens to Standard Oil Co. (New Jersey) controller's department, November 20, 1946.

[49] Sec. 202 of the Foreign Aid Appropriations Act of 1948 (Public Law 793, 80th Cong.) prohibits in transactions financed by ECA the "purchase in bulk of any commodities * * * at prices higher than the market price prevailing in the United States at the time of purchase adjusted for differences in the cost of transportation to destination, quality, and terms of payment." "Market prices prevailing in the United States" have been interpreted by the Comptroller General of the United States as meaning "* * * any price which is within the limits of the quoted prices in the United States at which the commodity is available for export." The Comptroller General also held that the prohibition of sec. 202 "was intended as a general price limitation policy to prevent extravagant spending of money appropriated by the act." See letter from Frank L. Yates, Acting Comptroller General of the United States, to the Administrator, Economic Cooperation Administration, August 4, 1948. Inserted on pp. 563–565 of Extension of European Recovery, hearings before the Committee on Foreign Relations, U. S. Senate, 81st Cong., 1st sess., on S. 833, February 1949.

Sec. 112 (a) of the Economic Cooperation Act of 1948, as amended (Public Law 472, 80th Cong.), obligates the Administrator to "provide for the procurement in the United States of commodities * * * in such a way as to (1) minimize the drain upon the resources of the United States and the impact of such procurement upon the domestic economy, and (2) avoid impairing the fulfillment of vital needs of the people of the United States." More specifically, the act directs that petroleum and petroleum products be procured from sources outside the United States to the maximum exent possible (sec. 112 (b)) and obligates the Administrator to "* * * take fully into account the present and anticipated world shortage of petroleum and its products * * *" in financing such procurement.

Coupled with these statutory obligations—which emphasize the need for maintaining low prices on ECA-financed transactions to prevent a diversion abroad of scarce domestic supplies and also prevent an inflationary impact of Marshall plan procurement on domestic prices—is the administrative obligation to take all steps necessary to maximize the use of available appropriations.

To implement this price policy, ECA regulation 1, as amended, established price conditions under which payment for programed commodities and services were to be made "only for purchases * * * which are made at prices that approximate, as nearly as practicable, lowest competitive market prices" (sec. 201, 22 (a) (1)).

[50] Net-backs on Middle East crude shipments to the United States have been variously estimated between $1 and $1.75. See letter from Paul Hoffman to Walter Faust, director of Socony-Vacuum Oil Co., Inc., and letter from H. M. Herron, of California Oil Co., Ltd., inserted in Extension of European Recovery, op. cit., pp. 565 and 569, respectively.

price test specified in section 202 of the Foreign Aid Appropriation Act, 1949, but also that, in general, prices charged on ECA-financed transactions should fully reflect competitive conditions affecting the market at the source of the commodity.

* * * * * * *

With particular reference to prices of crude oil and petroleum products, ECA dispatched on December 3, 1948, identical letters to * * * the principal suppliers of petroleum and petroleum products from offshore sources under the European recovery program, clearly stating this Administration's policy that it must be given the benefit of their lowest competitive market prices for these commodities.[51]

As import statistics continued to disclose a growing volume of Middle East crude shipments to the United States, the Administrator, on February 14, 1949, sent substantially similar letters to Gulf, Socony, Standard Oil (New Jersey), and Caltex, questioning the disparity in pricing:

The Administrator's position was that the price charged on sales of Middle East crude oil to United States destinations had an important bearing on the determination of the competitive market price at Middle East shipping points and that since the prices realized on such American sales appeared to be considerably lower than the prices then being charged on shipments to ECA destinations, a serious question was presented as to whether such latter prices reflected competitive market conditions in the Middle East.[52]

Confronted with the majors' position representing these movements of Middle East oil to the United States as "temporary and marginal" in character, ECA appointed, early in March 1949, a panel of five consultants to analyze the entire problem of Middle East crude-oil prices. This committee of experts, recognizing that Middle East crude supplies were becoming "more than adequate" for European requirements, reported late in March that:

* * * Under these circumstances, the *present formula* by which ECA authorizes a maximum price for purchases of Middle East oil, which formula was based on European needs of Western Hemisphere oil, *is ceasing to be justified. The adjustment of prices to the developing supply situation*, as frequently happens in many markets, *may well have lagged behind the emerging supply situation.*[53]

While not recommending immediate abandonment of the existing price (on the grounds that the large imports of 1948–49 into the United States "were the result of special circumstances not expected to recur") the committee urged that the companies "be asked to study the question of bringing present prices into line with the developing supply situation" and that "ECA should reconsider the present formula with a view to the possibility of its early abandonment." [54] On March 25, 1949, ECA, concurring with these conclusions, requested the companies to reexamine their prices on ECA-financed crude shipments to Europe.

As a result of this pressure, the companies, following the lead of Gulf Oil Corp. on its Kuwait crude oil, reduced their price for Middle East crude (36° API) to $1.88 per barrel f. o. b. Ras Tanura, ef-

[51] Extension of European Recovery, op. cit., p. 562. See also March 1, 1949, letter of Paul Hoffman to Chairman Sol Bloom appearing on pp. 771–773 of hearings before the Committee on Foreign Affairs, House of Representatives, 81st Cong., 1st sess., on H. R. 2362 and H. R. 3748, pt. 2, February–March 1949.

[52] Effects of Foreign Oil Imports on Independent Domestic Producers, hearings before the Select Committee on Small Business, House of Representatives, pursuant to H. Res. 22, pt. 2, November 1949, pp. 527–528.

[53] Effects of Foreign Oil Imports on Independent Domestic Producers, op. cit., p. 528. (Italics added.)

[54] Ibid.

fective April 1949. This 15-cent reduction defies rationalization under the formula and appears to have been made for the sole purpose of improving the industry's public relations.

Prices equalized at New York (the $1.75 price)

Although the substantial movement of Middle East crude oil into the United States which began in 1948–49 was characterized by the importing companies as "temporary and marginal" and by the special ECA committee as the "result of special circumstances not expected to recur," the shipments were described elsewhere as reflecting a profound, substantive change in the over-all world crude supply picture. As early as November 1948, Dr. Frankel said:

> * * * Any solution of the Middle East price problem worth our consideration would, therefore, have to meet certain essential requirements:
>
> It would have to allow for the fact that an increasing part of the output of the Middle East would go to the biggest market in the world, to the United States. Under the present set-up, with Western Europe being supplied from the Middle East on a "Caribbean plus freight" basis, and the east and southeast of Europe on a "Persian Gulf plus freight" basis, the f. o. b. return from sales to New York and other points similarly situated is lower than the return from markets nearer the actual source of supply.
>
> It is obvious that in a free market, with supplies readily available and producers keen to sell, there would be eventually a tendency for only one f. o. b. price level to be effective for all destinations. In the absence of agreements to the contrary, this would be inevitable. * * *
>
> *It should therefore, perhaps appear reasonable to establish quotations from the Middle East on an f. o. b. Persian Gulf basis, which would reflect the value of the crude if it were sold c. i. f. New York.*[55]

About a year and a half later (July 1949), the major oil companies, led by Gulf, adopted this suggestion, equalizing Middle East with Caribbean crudes at New York.[56] This resulted in a price reduction for Middle East oil of 13 cents—i. e., from $1.88 to $1.75 per barrel f. o. b. Ras Tanura (36° API crude).

The basic method for determining Middle East crude prices, f. o. b. Persian Gulf, through the process of equalizing delivered quotations with Caribbean-plus delivered prices in a specified market, remained unchanged. All that took place was a shift in the point of equalization from the United Kingdom to the east coast of the United States. This eliminated the embarrassing problem of discriminatory, higher realized prices for Middle East crude on sales to northwestern Europe than to the United States.

However, at the time this change was made, it was recognized that the use of straight USMC freight rates, as in the previous formula (under which the $2.03 price was set), would have resulted in a derived Middle East crude price, f. o. b. Persian Gulf, of only $1.30 per barrel. The reduction in the Persian Gulf f. o. b. price would thus have amounted to 58 cents per barrel instead of 13 cents per barrel. To avoid such a drastic reduction, the major oil companies took cognizance of the lower freight rates prevailing at the time and based their calculations on a "current freight rate" of USMC *minus 35¼ percent,* instead of the straight USMC rate used in the old formula. This

[55] See Oil Forum, November 1948, p. 457. (Italics added.) Dr. Frankel again called attention to this suggestion in the November 1950 issue of Oil Forum (p. 448) as having been "tentatively put forward" as early as 1947.

[56] Caribbean price plus freight to New York as USMC rates minus 35¼ percent (or United States Gulf price plus freight to New York at USMC rates minus 35 percent less 10½ cents import duty) minus freight from Ras Tanura to New York at USMC rates minus 35¼ percent=$1.75 per barrel for 36° API crude, f. o. b. Ras Tanura.

yielded a $1.75 realized price f. o. b. the Middle East on shipments to New York.

Virtually all shipments of Middle East crude are made in tankers either owned by or under long-term charter to the major world oil companies. The costs of operating the company-owned tankers and the rates for long-term charters are far more stable than "current freight rates" based on single voyages. Moreover, although the formula determining the $1.75 realized price to Middle East exporters was allegedly based on "current freight rates," tanker rates, both on company-controlled vessels and in the open market, have subsequently undergone considerable fluctuations without any accompanying change in the $1.75 price. While the avowed purpose of the formula was to enable Persian Gulf oil exporters to realize no more on sales to Europe than on exports to the United States, the failure to follow the formula in recalculating Middle East crude prices as "current freight rates" moved upward has resulted in a restoration of the discrimination against European buyers (as compared to American buyers) which the new formula was designed to remedy. This follows from the fact that the formula based on "current freight rates" should yield f. o. b. Middle East prices which fluctuate inversely with tanker rates—the higher the tanker rates, the lower the f. o. b. price and vice versa. From October 1949 to at least October 1950 "current freight rates" have for the most part been higher than USMC minus 35¼ percent, and since mid-August 1950 have climbed substantially above straight USMC rates. By the middle of 1951 they had reached approximately USMC plus 50 percent for company controlled vessels and USMC plus 150 percent in the open market. Nevertheless the industry kept the f. o. b. Persian Gulf price pegged at $1.75, when the use of current rates in the formula would have reduced Middle East realization by no less than 85 cents per barrel.

In short, the industry used "current freight rates" when they were lower than USMC rates and thereby derived a higher net realized price under the formula; but abandoned "current freight rates" completely when they rose above the low point on which the $1.75 was based. The action of the majors in pegging the $1.75 price regardless of markedly increasing freight rates (both on independent charter and company-controlled vessels) stabilized the Persian Gulf price, assured uniformity of delivered prices at all delivery points regardless of origin of shipments, and resulted in substantially higher realizations to all producers on Middle East crude shipments to Europe than on shipments from the same area to the United States.

The "Tapline" price ($2.41 based on the $1.75).—The recent completion of Aramco's Trans-Arabian pipeline (Tapline) and the lifting of the first tanker cargo from its eastern Mediterranean terminus at Sidon, Lebanon, on December 2, 1950, by Caltex [57] raised the question as to the proper price for Arabian crude oil f. o. b. Sidon, as compared to the $1.75 price f. o. b. Ras Tanura on the Persian Gulf.

ECA had an interest in this question since most of this crude was moving to European nations under ECA financing. The answer depended on whether the four owners of Aramco and Tapline—Standard of California, Texas Co., Standard of New Jersey, and Socony—passed

[57] Standard of California and Texas Co. marketed their share of Aramco oil through Caltex, a jointly owned subsidiary.

on to the purchaser part of the transportation savings resulting from the use of the 1,000-mile-long pipeline (with its 300,000 barrels of daily capacity) in place of the 7,000-mile round-trip tanker haul around the Arabian Peninsula via the Suez Canal. In October 1947, W. S. S. Rodgers, chairman of the board of the Texas Co., estimated tanker costs from the Persian Gulf to the Mediterranean to be 45–58 cents per barrel and pipeline costs at about 18 cents.[58] In other words the pipeline would effect a saving in transportation costs from the Persian Gulf to the Mediterranean of about 30 cents per barrel.

Socony "posted" a price for 36° API Arabian crude of $2.41 per barrel f. o. b. Sidon, while Caltex originally set its price at $2.45 and Esso at $2.55.[59] All three companies started with the $1.75 Persian Gulf price, f. o. b. Ras Tanura, and in effect added, at their own intra-company rates, *the tanker charges* from Ras Tanura to the eastern Mediterranean, including the Suez Canal toll charges.[60] This had the effect of charging European importers the same delivered price for Arabian crude shipped from the pipeline terminus at the eastern Mediterranean as they formerly paid for crude hauled all the way around the Arabian Peninsula—thereby making the pipeline transportation charge equivalent to that of a 10-day tanker haul.[61] Within a few days Caltex and Esso Export reduced their prices to the $2.41 level posted by Socony. This adoption of tanker charges from Ras Tanura to the Mediterranean as the pipeline charge for Tapline meant, of course, that none of Tapline's savings in transportation were passed on to consumers.[62]

As of August 1, 1951, ECA had made no judgment respecting the $2.41 f. o. b. Sidon price. But it is reported that ECA has questioned the $1.75 f. o. b. Persian Gulf price, upon which the $2.41 price was

[58] Petroleum Arrangements with Saudi Arabia, op. cit., pp. 24847 and 24887.

[59] New York Journal of Commerce, December 7, 1950, p. 1. Socony was the only company to publicly "post" Middle East prices—a practice it started on November 29, 1950, for Ras Tanura, Qatar, and Tripoli. Caltex and Jersey continued their former practice of notifying customers of price changes by "telegram." See New York Journal of Commerce, November 30, 1950, p. 13.

[60] The actual calculations involve adding freight from the Persian Gulf to the United Kingdom and subtracting freight at the same rates from the United Kingdom back to the eastern Mediterranean. The net difference represents freight from the Persian Gulf to the eastern Mediterranean. The three different Sidon prices arise from the fact that each company applied its own freight rates in making the calculations and that these, while closely in line with U. S. M. C. rates, nevertheless differed from each other. Thus, Socony used a 2-year time-charter rate which gave a tanker charge of 66 cents per barrel for shipment from the Persian Gulf to the eastern Mediterranean, calculated as described immediately above. Standard Oil of New Jersey used its own Panama Transport rates, a combination of time-charter and single-voyage rates, which came to 80 cents per barrel or $2.55 f. o. b. Sidon. Caltex used the U. S. M. C. rate which came to 70 cents per barrel or $2.45 f. o. b. Sidon. All rates included the Suez Canal toll of 18 cents per barrel. See the Wall Street Journal, December 6, 1950, p. 20; Platt's Oilgram News Service, December 4 and December 7, 1950; and the New York Journal of Commerce, December 7, 1950.

[61] The National Petroleum News of December 6, 1950, p. 30, in reporting on the posting of Middle East crude prices stated:

"* * * most sources believe that Mediterranean prices probably will take full advantage of tanker freight around the Arabian Peninsula until such time as the total crude requirements of European refineries are available from pipelines terminating in the Mediterranean."

[62] One observer indicated that if the savings were passed on, the f. o. b. price at Sidon would have to be reduced below $2.41, and this would create a two-price system for Persian Gulf Oil at destinations in Europe and the Western Hemisphere. It was reported that the capacity of Tapline in late 1950 was sufficient to take care of only about 40 percent of the crude moving from the Persian Gulf west through Suez, while about 60 percent moved by tanker and, unlike the pricing policies adopted with respect to Middle East refined products, the major American oil companies were represented as being reluctant to adopt a lower Sidon price which would result in price discrimination against European customers supplied from the Persian Gulf. Of course, if Tapline lowered the $2.41 Sidon price, Persian Gulf suppliers who shipped to Europe by tanker could avoid discrimination by absorbing the higher charges but this, it was argued, would result in discrimination against customers east of Suez. See New York Journal of Commerce, November 30, 1950, p. 13.

based. It has been stated that ECA, in discussions with the oil companies, indicated that the $1.75 price should be rolled back to $1.43, the intracompany price at which the foreign owners of Tapline (Jersey, Socony, Texas, and Standard of California) were selling Middle East crude to their American subsidiaries for delivery into the United States.[63] Should the $1.43 price become effective in the Persian Gulf, the $2.41 price at Sidon could be reduced without any fear on the part of the companies of a two-price system being created for Persian Gulf oil at destinations west of Suez. Consumers would thus, in effect, get the benefit of Tapline's transportation savings. ECA is reported to be giving serious attention to the $1.43 price, but as of August 1, 1951, the $1.75 price was still in effect.[64]

REFINED PRODUCTS PRICING AFTER WORLD WAR II

Most of the sales of crude oil in international trade, the pricing of which has been discussed in preceding sections of this chapter, are made by a producing company in one country to closely affiliated, often directly controlled, refining and marketing companies in other countries. Since this crude must be refined before it becomes salable to consumers, these sales of crude are largely in the nature of raw-material transfers among functionally differentiated, but financially or otherwise closely affiliated, companies whose profitable operation as a group depends more on the prices realized on sales of refined products to consumers than on the prices at which crude oil is transferred from one member of the group to another. Since the pricing of refined products is so important, it is pertinent to consider the changes in the method of pricing refined products since World War II.

The importance of refined-products pricing took on added dimensions following World War II with the expansion of both supply and demand for Middle East Oil. On the supply side Middle East producers, particularly the Aramco, Kuwait, and Bahrein companies, in which American international companies were financially interested, found themselves with wartime-built refining capacity and crude production with which they might enter the European market. And on the demand side reopening of western European markets after the war, together with the continuation of Government purchases for strictly military and naval consumption presented the prospect of a continuing and, in fact, increasing demand.

General characteristics of the refined products pricing structure

In the postwar period, refined products, as in the case of crude, were priced on the basis of a dual-basing-point system, the basing points being the United States Gulf and the Persian Gulf. As is true of most basing-point systems, the system used in the international

[63] The Oil and Gas Journal, March 8, 1951, p. 62.

[64] As noted above, ECA has not questioned the $2.41 f. o. b. Sidon price, but ECA did intervene to discourage an increase in the $2.41 price. Early in April 1951, Socony increased the f. o. b. Sidon price 16.5 cents per barrel to $2.575. The price increase was attributed to an increase in the 2-year tanker charter "award rates" which, as noted heretofore, were used by Socony in its formula for determining Sidon prices. The tanker charter "award rates" are established twice a year on April 1 and October 1, by a board of independent brokers in London. When the April 1, 1951, announcement showed an increase, Socony raised the Sidon price accordingly and made the increase retroactive to April 1, 1951. However, ECA intervened and none of the other owners of Tapline followed Socony's increase, and on April 16, 1951, Socony rolled back its price to the $2.41 level. See New York Journal of Commerce, April 11, 1951, p. 11; April 17, 1951, p. 11.

petroleum industry involved three characteristics—(*a*) the arbitrary determination of the base price, (*b*) phantom freight, and (*c*) freight absorption.

Base price.—As in the case of crude, the base prices at the Persian Gulf for refined products were the same as the United States Gulf base prices, which in turn were taken from Platt's Oilgram. There was, however, this unusual feature of the system: the base price for shipments *east* of Suez was higher than the base price for shipments *west* of Suez. Until September 1948, the "high of Platt's" at United States Gulf was used as the base price on Persian Gulf shipments to China, the "mean of Platt's" on shipments to all other markets east of Suez, and the "low of Platt's" in shipments west of Suez. On shipments to China use of the high of Platt's quotations for shipment from the Persian Gulf yielded the highest net realizations to all shippers regardless of whether the oil originated in the Middle East, the Far East or the Western Hemisphere.

Phantom freight.—Although, as has been noted, the dual basing-point system reduced the amounts of phantom freight paid by purchasers on shipments from the Middle East, the dual system still retained sizable amounts of phantom freight. In the Far East, for example, where the Persian Gulf base price plus transportation charges determined delivered prices, oil producers located in India and the Netherland's East Indies still continued to enjoy phantom freight in delivery to markets that were freightwise nearer to their sources of supply than the Persian Gulf. The same was true in the important consuming markets of Europe and Africa commonly designated as "west of Suez." Here Egyptian and European producers, who, however, produced and marketed only a fraction of the area's total supply, enjoyed the advantage of phantom freight in selling their refined products in markets which were freightwise nearer than either the Gulf of Mexico or the Persian Gulf.

Freight absorption.—At the time the Persian Gulf was made a basing point, little Middle East oil, either crude or refined, was moving to western European markets and the absorption of freight was thus not a matter of any real importance to Middle East producers. But as Middle East output rapidly increased following the war, it began to press heavily upon the western European markets. Under the dual basing point system such shipments of Middle East refined products required the absorption of freight. Specifically, under this system shipments could be made by Middle East producers as far west as Italy without freight absorption. But beyond that point freight absorption was required in order to obtain delivered prices identical to the delivered prices based on the United States Gulf, with the net realized price of course declining as the length of the shipment and the amount of freight absorption increased. That is to say, in matching the delivered prices in western Europe based upon the freightwise nearer United States Gulf base price, the Middle East producer had to absorb freight from Italy to the point of destination. As western Europe became more and more important as a market for the rapidly expanding Middle East output, the necessity of absorbing freight became a matter of great concern to Middle East producers. Under United States Maritime Commission rates, which were used in determining prices from both United States Gulf and Persian Gulf, Middle

East producers were obliged to absorb freight in amounts ranging up to a maximum of $4.35 per long ton on shipments to northwestern Europe. Thus, in shipping to Greece, where no freight absorption was required, the Middle East supplier realized over twice as much as on shipments to northwestern Europe.

The shift to a Caribbean freight base

The above pricing practices were followed by the major oil companies fairly uniformly until June 1948, when Standard of New Jersey initiated the practice of meeting "Caribbean plus" prices instead of "United States Gulf plus" at European markets west of Greece for its Middle East product shipments. This meant a slightly lower delivered price in western Europe (and hence a slightly lowered net realization on Middle East shipments to the same destination) because freight rates from the Caribbean to Europe were somewhat lower than those from the United States Gulf. By December 1948, all the other major suppliers had substituted the Caribbean for the United States Gulf as the basing point for determining the delivered prices for Middle East products in European markets. Collaterally, on shipments east of Suez, Persian Gulf quotations were reduced to the low of Platt's at the United States Gulf.

Middle East prices based on USMC minus 30 percent

Until July 1, 1949, petroleum products shipped to western Europe from the Persian Gulf were priced by Cal-Tex on the basis of USMC rates, and on these shipments Caltex absorbed freight of $4.35 per ton. This meant that net realized prices f. o. b. Middle East on shipments to Europe were reduced by $4.35 per ton below the prices realized on deliveries to eastern Mediterranean ports. Standard Oil Co. of New Jersey calculated its prices for shipments of Persian Gulf products to the United Kingdom on the basis of its own intracompany freight rates which approximated those of USMC and this resulted in freight absorption at times as high as $4.65 per ton.

Between January and July 1949, tanker rates fell sharply below USMC levels. Esso and Cal-Tex company tanker rates followed the current "freight rate" market down but lagged somewhat behind. As in the crude oil situation, the companies adopted the lower tanker rate in determining the amount of freight to be absorbed in calculating f. o. b. Middle East refined product prices for sales to western Europe. Use of a lower freight rate (USMC minus 30 percent) meant a reduction in the amount of freight absorbed on Middle East shipments. In the case of Great Britain the extent of the reduction in the amount of freight absorbed was $1.30 per ton (from $4.35 per ton *below* United States Gulf quotations to $3.05)—or an increase in net realized prices of $1.30 per ton. This price structure continued in force for over a year despite the fact that actual freight rates, whether single voyage charter, long-term contract or company-owned, ranged from slightly below to substantially above USMC minus 30 percent.

ECA reestablished Middle East prices based on straight USMC rates

On September 15, 1950, ECA issued an order which in effect required Middle East suppliers in shipping west to use the full USMC rates

in calculating delivered prices rather than USMC minus 30 percent.[65] This action wiped out the savings to the Middle Eastern suppliers resulting from their action in basing their delivered prices on USMC rates minus 30 percent. Under this higher freight rate, freight absorption rose, and the net realized price declined.

At the same time, the Middle East oil producers under the order went on what might be referred to as a "zone realized price system" for the Mediterranean. That is to say, shipments to any destination in the Mediterranean were to yield the same net realized price. The purpose of this action was to eliminate discrimination in the realized prices on sales within the Mediterranean area. The realized price on shipments to Gibraltar would be the same as on shipments to Greece. This was in conformity with ECA's established policy of paying no more than the lowest market price for ECA financed goods. The lowest market price in this instance was $3.50 per ton below United States Gulf quotations for the Mediterranean, and somewhat lower to designated western European ports. By applying the $3.50 per ton freight differential on products to all destinations in the Mediterranean east of Gibraltar, the ECA order had the effect of eliminating price discrimination against Turkey, Greece, Italy, and North Africa. It meant price reductions of approximately $3.50 a ton to Greece and nearby countries and $2.40 a ton to Italy and adjacent areas.

The western boundary of this "zone" was Gibraltar, to which shipments required a freight absorption at USMC rates of $3.50 per ton (below United States Gulf Coast quotations) to equalize Middle East delivered prices with the delivered prices for products from the Western Hemisphere. ECA applied the Gibraltar net realized price to *all* destinations in the Mediterranean east of Gibraltar as the lowest competitive market price f. o. b. Arabian ports and Bahrein Island.[66] In order to equalize Persian Gulf prices with United States Gulf prices, Middle East refiners were required to absorb $4.35 per ton on shipments to the United Kingdom and Atlantic coast ports between Bordeaux and Hamburg. On shipments to Sweden the freight absorption was $4.65 per ton, to Denmark $4.75, and to Norway $4.85, all based on USMC rates.[67]

The amendment was attacked in the trade press as "a threat to the entire foreign pricing structure, particularly in the east-of-Suez market where private transactions were still made at f. o. b. prices equivalent to United States Gulf." According to one trade paper,

> * * * it could virtually eliminate competition in some other world markets. The agency's requirement that Persian Gulf products must be priced at $3.50 per ton below United States prices for shipment to some European areas, will result in these products arriving in some areas at prices lower than competitive products originating in the Gulf of Mexico or Caribbean areas, it was noted.

[65] The order was amendment 5 to ECA Regulation 1, Federal Register, vol. 15, No. 185, September 27, 1950, p. 6492.

[66] In determining the price for loadings from Kuwait ports the freight absorption was set at $4 per long ton and from Iranian ports at $4.20 a long ton to adjust for higher USMC freight charges from those more distant ports in the Persian Gulf.

[67] ECA Regulation 1, amendment 5, effective September 1, 1950.

The obvious result, it was added, would be that shippers from the Gulf and Caribbean would reduce prices, forcing Middle East suppliers to make further cuts in order to comply with the rule.

MIGHT WITHDRAW SUPPLIES

The probable net result of the downward spiral would be that either the Caribbean or the Persian Gulf suppliers would withdraw from the particular market, thus eliminating competition to a degree, according to trade thinking.

This paradoxical situation is brought about by ECA's using flat USMC freight rates as a basis for designating the price differential between Western Hemisphere and Middle East oil. However, USMC freight rates rarely, if ever, prevail—tanker charters usually being fixed at percentages above or below these rates.[68]

The opposition of the major oil companies manifested itself initially in their failure to bid on petroleum products sought by the Greek government and the Athens Piraeus Electricity Co. under ECA financing. It is interesting, moreover, to note that British suppliers in the Middle East who were permitted to charge the full United States Gulf quotation as Persian Gulf prices, if quoting in their own currency, also failed to bid. Of the Athens Public Utility bid for 150,000 tons of fuel oil to be submitted by December 7, 1950, it was reported that:

* * * Trade circles, however, were convinced that no bids for shipment out of the Middle East, the cheapest supply source for Greece, would be made by American companies in this case either if American firms were held to the terms of ECA's price ruling.[69]

It is significant to note at this point that while the industry refused to accept this reduction in Middle East product price on shipments to Greece, which involved a relatively small volume of sales, it accepted the reduction on a far greater volume of sales moving to western Europe.

SUMMARY

The use of the Gulf-plus basing point system, both in its original and modified forms, to price crude oil and refined petroleum products served two basic purposes of the major international oil companies:

(1) It eliminated differences in delivered prices among the various sellers at any given point of destination, thereby making the selection of one seller over another a matter of indifference to the buyer insofar as price was concerned.

(2) It made the relatively high United States Gulf prices the basis for both crude oil and refined products prices throughout the world.

The first break in single basing point pricing occurred during World War II when the Persian Gulf was made a basing point with prices equal to those prevailing at United States Gulf ports. In 1943, when the British Government began buying large quantities of bunker fuel in the Persian Gulf for the use of its navy, British officials objected to the large amounts of phantom freight involved in buying these products on the basis of Gulf-plus and insisted that the Persian Gulf

[68] New York Journal of Commerce, August 30, 1951, p. 1.
[69] Ibid., November 21, 1950, p. 20.

be made a basing point. The suppliers thereupon established the Persian Gulf as a basing point with base prices for refined products equal to those quoted by Platt's Oilgram for United States Gulf ports. Later, in 1945, on sales to the United States Navy, American companies operating in the Middle East likewise established a Persian Gulf base price for crude oil and refined products equal to the United States Gulf price.

Under the dual basing point system thus set up, the point of equalization, i. e., the point in the important European consuming market at which Persian Gulf products and United States Gulf products were delivered at equal prices, using USMC transportation charges from both basing points, was the mid-Mediterranean—i. e., shipments from either producing area beyond that point required the absorption of freight. Postwar reopening of western European markets, which had been closed to Middle East producers during the war, made this absorption of freight important, especially to Middle East producers when they sought to supply European markets from their rising production of Middle East crude and refined products.

Between November 1946, when OPA price controls were terminated, and April 1948, United States Gulf prices for crude oil and refined products moved sharply upward. Persian Gulf base prices for refined products continued to be equal to those quoted in Platt's Oilgram, "Platt's high" being used as the Persian Gulf base for shipments to China, "Platt's mean" for shipments to other destinations east of Suez, and "Platt's low" for destinations west of Suez, i. e., mainly the Mediterranean and Europe. Thus, the Persian Gulf base prices for refined products remained equal to United States Gulf prices.

Advances in the Persian Gulf base price for crude, however, lagged behind the advances in United States Gulf crude prices, and finally became stabilized at about the end of 1947 at $2.22 per barrel. This price, although lower, was tied to the United States Gulf price by a definite pricing formula under which the price of crude originating in both areas was equalized at the United Kingdom, thereby opening a wider market for Persian Gulf oil without absorbing freight under the basing point formula. The formula consisted of adding to the quoted base price for Venezuelan crude the USMC freight rate to the United Kingdom, and deducting therefrom the USMC freight from the Persian Gulf. This yielded the base price for crude at the Persian Gulf. Thereafter, this formula, sometimes using USMC rates and sometimes using lower freight charges when open market charter rates fell below USMC rates, was systematically used to link the Persian Gulf base price for crude to the higher base price prevailing at United States Gulf ports. This same formula was used in July 1949 when, in recognition of the fact that Persian Gulf crude was moving to the United States in quantity, the point of equalization was moved to New York. This established a base price of $1.75 per barrel f. o. b. the Persian Gulf (Ras Tanura) which thereafter remained unchanged up to the time this report was prepared (August 1951).

When open market charter rates advanced sharply after 1949, application of the formula would have reduced the Middle East base price by about 85 cents per barrel. The formula, however, was not applied and the Persian Gulf base price remained unchanged. Moreover, when the Trans-Arabian pipeline from the Persian Gulf to Sidon on the Mediterranean was completed in December 1950, the f. o. b. price $2.41 established at Sidon was based on the $1.75 Persian Gulf price plus water freight from Ras Tanura to the eastern Mediterranean, including the Suez Canal toll. In other words the tanker transporation charge was made the rate for transmitting crude oil by pipeline. This avoided establishing different prices in the eastern Mediterranean for oil transported by pipeline and by tanker, but it also enabled the companies owning and using the pipeline to keep for themselves all savings of pipeline transportation over tanker freight. Also, for more than a year after the $1.75 base price for crude was established at the Persian Gulf, Middle East refined products continued to be quoted at Platt's Oilgram prices plus whatever freight charges were currently being used to determine delivered prices.

When ECA began financing shipments of refined products it found that the use of straight basing point pricing resulted in price discrimination as between countries to which it financed shipments. To correct this, it divided the European market into zones and ruled that the price it would pay for Persian Gulf products delivered in a given zone would be no more than the realized net-back for Persian Gulf products computed by deducting the USMC rate from the Persian Gulf to the zone from the alternative delivered price for Western Hemisphere oil to that zone. Since USMC rates were higher than either company rates or open market charter rates, this reduced the net realization of Middle East suppliers of refined products financed by ECA. The industry objected strenuously to this reduction.

Throughout the period under review, the major international oil companies have clung tenaciously to the basing point method of pricing. Regardless of the fact that they modified the single basing point system and made other concessions largely as the result of government pressures, the existing price structure is still highly profitable to the small number of major international oil companies that dominate world production. Under the resulting price structure, American companies operating in the Middle East have made substantial net profits on their combined producing, refining and marketing operations. Thus, according to the published statements of Standard Oil Co. of California and the Texas Co. it appears that these and other joint owners of Aramco and Bahrein Oil Co., Ltd., realized net profits amounting to about 91 cents per barrel of crude oil produced, refined,

and marketed by these two companies in 1948; 95 cents in 1949, and 85 cents in 1950.[70]

These profits were realized under a system of pricing that:

1. Bases delivered prices throughout the world on the relatively high United States costs, notwithstanding the fact that this country had become a net importer of petroleum.

2. Uses schedules of uniform freight charges that may not have any real relationship to transportation costs actually incurred, especially by the major companies that own or control the bulk of the world's tanker facilities.

3. Is supported and maintained by effort on the part of the major international companies to adjust production to world demand. Joint ownership and private agreements in foreign countries and the conservation movement in the United States all facilitate these efforts.

Thus, although a new basing point was established, although the point of equalization was changed on several occasions, and although other modifications were made, such as the use of arbitrary percentages of USMC freight rates in computing delivered prices, the

[70] It is necessary to consider the combined net profits of the Aramco and Bahrein companies as a group for the reason that Bahrein refines and Caltex markets large quantities of Aramco's crude oil. Aramco does not publish an annual statement and the only published statements available for Bahrein covering the "Bahrein-Caltex group" are for the years 1949 and 1950. Standard of California and Texaco, however, in recent years have published annually estimates of their respective equities in the net profits of the two companies after adjustments, the nature of which is not specified. These equities are proportional to the respective stock holdings of the two companies, and, in general, agree as to amounts. Lack of large storage facilities makes it necessary for Bahrein and Aramco production to be marketed promptly. The following tabulation based on the equities published by Standard of California relates the estimated total combined net profits of Bahrein and Aramco to the total crude oil which they produced, refined, and marketed in 1948, 1949, and 1950.

Year and company	Standard Oil (California's) equity [1]	Percent control by Standard Oil (California)	Total estimated net profit	Crude oil produced (thousand barrels) [2]	Average net profit per barrel (cents)
1948:					
Bahrein	$28,181,773	50	$56,363,546	10,915	
Aramco	24,968,299	30	83,227,663	142,853	
Total			139,591,209	153,768	90.8
1949:					
Bahrein	30,688,796	50	61,377,592	10,985	
Aramco	34,518,646	30	115,062,153	174,008	
Total			176,439,745	184,993	95.4
1950:					
Bahrein	25,310,285	50	50,620,570	11,016	
Aramco	38,212,174	30	127,373,913	199,547	
Total			177,994,483	210,563	84.5

[1] Moody's Industrials, 1951, pp. 2241 and 2244.
[2] World Oil, July 15, 1951, p. 64.

essential character of the "Gulf-plus" basing-point system has remained unchanged. It still fulfills its basic purposes of eliminating price differences among sellers to any given buyer, and of making the United States Gulf price the principal determinant of the *level* of world prices. As such, it is highly profitable to the international companies. By performing these functions, the system serves as a highly useful complement to the other types of controls exercised over the international petroleum industry by its major companies.

The propriety of continuing into the future this pricing system has been questioned by industry spokesmen themselves. Thus in describing the underlying reasons for deviations from a strict use of "Gulf-plus", Dr. Frankel in 1948 stated:

> During the last two years or so, factors have come up which, severally and jointly, have begun to render the erstwhile set-up more and more obsolete: firstly, the U. S. A. has become a net importer of petroleum, which makes it more difficult to maintain the conception that the U. S. Gulf is, in fact, the fountain head of the world's oil; secondly, moving inversely, the Middle East crude output has risen to such an extent that it is bound soon to cover the Eastern Hemisphere demand and can no longer be considered to be supplementary in its scope; thirdly, the repeated increases in the Domestic American price level, which took place in 1947, and which were determined by domestic causes, and which may be followed by further similar moves, have greatly widened the gap between similarly increased Middle East (and for that matter, Latin American) crude prices and the level of cost of production as it is known or as it has been estimated in the past.[71]

After considering somewhat sympathetically the rationalization by which Middle East producers still adhere to this system, Dr. Frankel called attention to the basic weakness of the argument by pointing out that—

> Such conceptions, however rational they may be from the point of view of the operators themselves, do not entirely meet the case when it comes *to facing the responsibilities of big companies toward consuming interests.*[72]

[71] Dr. P. H. Frankel, What Price Oil, the International Structure, The Oil Forum, November 1948, p. 439.
[72] Ibid., p. 439. [Italics added.]

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